HIGHER BOOK-KEEPING AND ACCOUNTS

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FIFTH EDITION

Fifth Impression

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London

MACDONALD & EVANS

8 JOHN STREET, BEDFORD ROW, W.C.1

1938

MADE AND PRINTED IN GREAT BRITAIN
BY UNWIN BROTHERS LIMITED, THE
GRESHAM PRESS, LONDON AND WOKING

PREFACE

THE gratifying reception accorded to previous books of the author has induced him to add the present volume to the list of his published works, in order to bridge the gap between *Book-keeping and Accounts* and his advanced treatise entitled *Accounting*. The publication of the present work completes the author's series of book-keeping and accountancy text-books, and these now meet students' needs no matter what the stage of advancement they may have reached.

"Elementary Book-keeping."—This is the beginner's book, and the style of writing and method of exposition is adapted accordingly. It fully covers the requirements of the junior student sitting for the elementary examinations of such examining bodies as The Royal Society of Arts; The Union of Lancashire and Cheshire Institutes; The County Council of the West Riding of Yorkshire; The Midland Counties Union of Educational Institutions; The National Union of Teachers; The East Midland Educational Union; The College of Preceptors; and The London Chamber of Commerce.

"Book-keeping and Accounts."—This book more than meets all the requirements of students taking the intermediate examinations of the Authorities mentioned above, and it is also a complete text-book for the self-taught student. A fully-worked Key to this book is available.

"Higher Book-keeping and Accounts"—the volume now offered—carries the treatment of the subject to the degree of mastery expected of those offering themselves for the most advanced examinations of the Examining Authorities mentioned above, and also for the examinations of the various Professional Societies. A Key to this book is now available.

"Accounting."—This volume is the most comprehensive of the author's works, and treats the subject-matter included in advanced examination syllabuses in great detail and very practically, not only to enable the ambitious student to secure distinction in his final examination, but also that he may equip himself thoroughly for the practical duties that will confront him as Company Secretary, Accountant, and Auditor, in the modern business world. It is hoped that this work, now in its fourth edition, will prove of service to the student long after he has done with the examination room.

At least 75 % of the practical work undertaken by the present-day book-keeper, accountant, and auditor relates to private partnerships, and joint-stock companies. It is therefore not surprising that, in examination work, questions on partnership, and joint-stock com-

panies' accounts, should be equally prominent. These facts are recognised in *Higher Book-keeping and Accounts*, and the space allotted to partnership and joint-stock companies has been sufficiently generous to permit of exhaustive treatment of these subjects.

Further, throughout this work, as the very numerous textual illustrations will show, the author has been at pains to deal with the special difficulties of students, as they have been revealed to him throughout his twenty years' experience as an examiner to Professional and Educational Authorities in book-keeping, accounting, and auditing.

In view of the examination in banking held by the Royal Society of Arts, and the questions on General Commercial Knowledge asked in the examination papers of the Professional Societies, the treatment of bills of exchange, cheques, and promissory notes and the subjects of banking and foreign exchange is much fuller than is usual in a text-book on book-keeping. Moreover, modern business demands a more intimate acquaintance with these important subjects than has sufficed in the past. But these chapters do not profess to give more than an outline of the subjects, and that often without the qualifying, explanatory, and critical statements that more extended treatment (impossible in a general text-book on book-keeping) would have permitted.

The author's thanks are due, and are here accorded, to E. B. V. Christian, Esq., LL.B., Solicitor, who has contributed the chapter on Partnership Law.

SPENCER HOUSE, SOUTH PLACE,
LONDON, E.C.2.
October 31st, 1927.

PREFACE TO THE FOURTH EDITION

THIS edition has been thoroughly revised in conformity with the *Companies Act*, 1929.

August 1st, 1930.

PREFACE TO THE FIFTH EDITION

Fifth Impression

THIS edition is substantially the same as the fourth edition except for minor corrections, and the revision of the Income Tax chapter in the light of the *Finance Act*, 1938.

F. D. MORRIS
A. K. FISON

August, 1938

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HIGHER BOOK-KEEPING AND ACCOUNTS

CHAPTER I

SINGLE ENTRY

THE advantages of Double Entry and the disadvantages of Single Entry book-keeping have been dealt with in the elementary text-books and need not be discussed here.

Definition.—The term "Single Entry" signifies that the method, or lack of method, employed in recording the transactions of a business, fails in some essential to deal with the two-fold aspect of every transaction; in other words, that the double entry maxim "every debit must have its credit" is ignored. Single entry book-keeping is merely defective book-keeping. Pure single entry is seldom found in practice; at the very least a Cash Book will be kept.

A typical set of single entry books usually comprises (*a*) Ledger for keeping the personal accounts of debtors and creditors; (*b*) Sales Book, the details being posted to customers' personal accounts. If no actual book is kept the sales are entered direct from the invoices. No posting is made of sales totals. (*c*) Single-column Cash Book. Items relating to personal accounts are posted, but no postings are made to nominal accounts. (*d*) Creditors' accounts are posted from a waste book, no Purchases Book being kept; (*e*) Discounts allowed and received are entered direct in the personal ledger accounts, no other records being made. To some extent, therefore, single entry is a composite method. But it provides no check ensuring accuracy, and no classified information, both of which are essential to a scientific system of book-keeping. The trader's financial position can be ascertained only by means of a Statement of Affairs.

Ascertaining Profits under Single Entry.—If no books at all were kept, it would still be possible, theoretically, to ascertain the profit for a particular period by calculating the increase in the net value of the assets at the end of the period over the net value of the assets at the beginning of the period, adjustments being made for any amounts paid in or withdrawn by the proprietor during the period. If we could assume that the assets and liabilities were accurately recorded, both at

the beginning and the end of the period, then the resulting profit or loss so ascertained would be the same as that shown by a Profit and Loss Account prepared from books kept on double entry principles. But no details as to how the profit was made, or what the expenses were, would be available, and comparisons with previous periods would be impossible. Apart from these grave defects, it would be found in practice that the data necessary for the preparation of an accurate inventory of assets and liabilities at any date would not be available by such loose methods.

Conversion into Double Entry.—The most satisfactory way of preparing accounts from single entry books is to instal a double entry system. A Statement of Affairs prepared at the date of installation would provide the basis for the opening Journal entries; and it would also determine the profit for the *past* period, if the capital at the beginning of that period were known.

Illustration.—J. Young commenced business on January 1, 19.., with a cash capital of £1,000, with which he opened a business banking account. He kept a personal ledger in which he recorded all transactions with customers and wholesale houses. All payments were made by cheque and all receipts banked. At December 31, 19.., he found that he owed £550, and had owing to him £1,400. His Stock, valued at cost price, was £350, and his Bank Balance was £250. Other assets valued at cost were: Fixtures, £150; Motor Lorry, £500; Rent paid in advance, £50. He had drawn regularly £5 per week during the year, but owing to difficulty in collecting book debts he had to pay in an additional £300 capital during December.

(1) Calculate his profit for the year, writing off 8 % per annum on the fixtures and 20 % per annum on the motor lorry. Interest on opening Capital to be computed at 5 %.

(2) Prepare a "Statement of Affairs" as at December 31, 19.., with a view to opening a set of books as from the following day.

J. Young.

STATEMENT OF PROFIT, DECEMBER 31, 19...

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Creditors				550	0	0	Fixtures, at cost ..	150	0	0			
Capital as at Jan. 1st	1,000	0	0				*Less* Depreciation ..	12	0	0			
Add cash paid in ..	300	0	0								138	0	0
				1,300	0	0	Motor Lorry, at cost ..	500	0	0			
							Less Depreciation ..	100	0	0			
				1,850	0	0					400	0	0
Balance carried down				998	0	0	Payments in advance				50	0	0
							Stock				350	0	0
							Debtors				1,400	0	0
							Cash at Bank				250	0	0
							Drawings				260	0	0
			£	2,848	0	0				£	2,848	0	0
Interest on Capital ..				50	0	0							
Net Profit				948	0	0	Balance brought down				998	0	0
				£998	0	0					£998	0	0

J. Young.

STATEMENT OF AFFAIRS, DECEMBER 31, 19..

Liabilities	£	s.	d.	£	s.	d.	Assets.	£	s.	d.	£	s.	d.
Creditors				550	0	0	Fixtures				138	0	0
Capital Account as at Jan. 1st	1,000	0	0				Motor Lorry				400	0	0
Add Cash paid in ..	300	0	0				Payments in advance—Rent				50	0	0
							Stock				350	0	0
Add Interest on Capital	50	0	0				Debtors				1,400	0	0
Add Net Profit ..	948	0	0				Cash				250	0	0
	2,298	0	0										
Less Drawings.. ..	260	0	0										
				2,038	0	0							
			£	2,588	0	0				£	2,588	0	0

The items in the above Statement of Affairs can now be journalised and posted to a Private Ledger. The cash balance will be the first entry in the Cash Book. The existing Sales and Bought Ledger balances will be agreed with the schedules, and the totals of the schedules with those in the Statement. Subsidiary books, such as Sales Book, Purchases Book, Returns Book, Petty Cash Book, will be brought into being, and instructions be given that adequate records of all transactions shall be kept, and that no entries shall be made in the Ledgers except by posting from a book of original entry.

Conversion by Completion of Double Entry.—In some cases it will be possible to prepare an approximately correct Profit and Loss Account by carrying through the double entry in detail, as, for example, where a Cash Book has been correctly posted to the Sales and Bought Ledgers; Sales and Purchases Books have been kept; Discount has been recorded, and Returns and Allowances have been entered in special books. It will then be necessary to open Nominal Accounts; complete the postings of expense accounts, etc., from the Cash Book; and record the impersonal aspect of the transactions with debtors and creditors by totalling the Sales and Purchases Books, crediting a Sales Account with the sales and debiting a Purchases Account with the purchases. Generally, however, it will be impracticable to complete the double entry in detail, and the figures for sales, purchases, expense items, etc., will have to be found by analysis and total accounts. The accuracy of the accounts will, of course, depend upon the accuracy of the original records. Where, e.g., cash receipts are not banked intact, but partially used for making petty cash and other payments, the completeness of the records will largely depend on the tenacity of the proprietor's memory. Where no Sales and Purchases Books have been kept, the sales, purchases, returns, etc., can be ascertained by analysing the Personal Ledgers, or by summarising the duplicate copy sales, invoices, etc. When accounts have been raised for Cash, Total Debtors, and Total Sales, and the double entry has been com-

pleted, a Trial Balance can be extracted, adjustments made, and accounts prepared in the usual way.

Illustration.—J. Young (see previous illustration) desires a Trading and Profit and Loss Account for the year ended December 31, 19.., and a Balance Sheet as at that date for submission to the Inspector of Taxes. With the exception of the Personal Ledger (entered up on the "slip" system from invoices, credit notes, counterfoil cheques, etc.) and the Bank Pass Book, he has kept no books, except a Petty Cash Book.

Since all cash received is banked and all payments are made by cheque, the Pass Book will serve for the analysis of cash; and an analysis of the Personal Ledger will give details of sales, purchases, etc. Loose sheets ruled with columns, each appropriately headed, will be used for the analysis.

The following are the results of the analysis :—

ANALYSIS OF CASH (BANK) BOOK.

Receipts.	£	s.	d.	£	s.	d.	Payments.	£	s.	d.	£	s.	d.
Capital paid in Jan. 1st				1,000	0	0	Purchase of Fixtures..				150	0	0
Additional Capital ..				300	0	0	Purchase of Lorry ..				500	0	0
Received from Debtors				3,080	0	0	Rent				250	0	0
							Drawings				260	0	0
							Wages				300	0	0
							Trade Expenses (detailed)				670	0	0
							Petty Cash				10	0	0
							Paid to Creditors ..				1,990	0	0
							Balance, Dec. 31st ..				250	0	0
			£	4,380	0	0				£	4,380	0	0

ANALYSIS OF SALES LEDGER ACCOUNTS.

Debits.	£	s.	d.	£	s.	d.	Credits.	£	s.	d.	£	s.	d.
Sales				4,600	0	0	Cash received				3,080	0	0
							Discounts allowed ..				30	0	0
							Returns				50	0	0
							Contras (Bought Ledger)				40	0	0
							Balances, Dec. 31st ..				1,400	0	0
			£	4,600	0	0				£	4,600	0	0

ANALYSIS OF PURCHASES LEDGER ACCOUNTS.

Debits.	£	s.	d.	£	s.	d.	Credits.	£	s.	d.	£	s.	d.
Cash paid				1,990	0	0	Purchases				2,610	0	0
Discount received ..				10	0	0							
Returns				20	0	0							
Contras (Sales Ledger)				40	0	0							
Balances, Dec. 31st ..				550	0	0							
			£	2,610	0	0				£	2,610	0	0

Accounts should be opened for Cash, Total Debtors, Total Creditors, Sales, Purchases, etc., and the above results journalised and posted. A Trial Balance will then result as follows :—

J. Young.

TRIAL BALANCE, DECEMBER 31, 19..

	Dr. £	s.	d.	Cr. £	s.	d.
J. Young, Capital Account				1,300	0	0
Drawings	260	0	0			
Fixtures	150	0	0			
Motor Lorry	500	0	0			
Cash at Bank	250	0	0			
Debtors	1,400	0	0			
Creditors				550	0	0
Sales				4,600	0	0
Sales Returns	50	0	0			
Purchases	2,610	0	0			
Purchases Returns				20	0	0
Discount allowed	30	0	0			
Discount received				10	0	0
Rent	250	0	0			
Wages	300	0	0			
Trade Expenses (detailed)	670	0	0			
Petty Expenses (Petty Cash)	10	0	0			
	£6,480	0	0	£6,480	0	0

J. Young.

TRADING AND PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..

Dr.	£	s.	d.	£	s.	d.	Cr.	£	s.	d.	£	s.	d.
To Purchases (less Returns)				2,590	0	0	By Sales (less Returns)				4,550	0	0
,, Wages				300	0	0	,, Stock				350	0	0
,, Balance carried down being gross profit				2,010	0	0							
			£	4,900	0	0				£	4,900	0	0
To Rent				200	0	0	By Balance brought down				2,010	0	0
,, Trade Expenses				670	0	0							
,, Sundry Expenses				10	0	0							
,, Discount				20	0	0							
,, Depreciation:—													
Fixtures	12	0	0										
Motor Lorry	100	0	0										
				112	0	0							
,, Interest on Capital				50	0	0							
,, Net Profit				948	0	0							
			£	2,010	0	0				£	2,010	0	0

The Balance Sheet will, of course, be the same as in the previous illustration.

EXAMINATION QUESTIONS

1. Name some of the defects of single entry book-keeping. (*National Union Teachers.*)

2. In a firm where nothing beyond a Cash Book has been kept and stock taken, you are required to prepare a Balance Sheet, Trading, and Profit and Loss Accounts. Describe your methods. (*Incorporated Accountants.*)

3. The books of a business have been kept by single entry. They are made up to a date, stock has been taken and valued, and it is desired to convert them into double entry. Explain how this is to be done. (*Chartered Secretaries.*)

4. A retail trader had not kept proper books of account, but from the following details you are required to ascertain the profit or loss for the year ended December 31, 19.., and also to prepare Statement of Affairs at that date :—

	Jan. 1, 19. .	Dec. 31, 19. .
	£	£
Stock-in-trade	1,670	1,850
Sundry Creditors	1,540	1,400
Sundry Debtors	1,120	1,050
Cash in hand	25	120
Bank Overdraft	2,020	1,940
Bills Receivable	1,505	1,420
Fixtures, Fittings, etc.	150	150
Motor Van	190	190

The drawings during the year amounted to £260. Depreciate Fixtures, etc., by 10 %, write £30 off Motor Van. As regards the Debtors, it is ascertained that £50 is irrecoverable and a further reserve of 5 % should be made. Also reserve £70 in respect of Bills Receivable. (*London Association Accountants.*)

5. You are instructed by a client to convert his single entry system into one of double entry. How would you proceed? Give entry or entries based on the following statement of Assets and Liabilities :—

Liabilities.	£	s.	d.	Assets.	£	s.	d.
Sundry Creditors ..	2,146	9	2	Sundry Debtors ..	3,596	7	2
Loans	500	0	0	Cash	561	9	2
Bills Payable	1,685	4	9	Stock	1,924	2	8
Bank Loan	500	0	0	Furniture	187	0	0
				Premises	2,000	0	0

(*Chartered Accountants.*)

6. Robert Webber keeps his books by the single entry method. His financial position on January 1st was as follows :—

Cash in hand, £12 10s.; Stock-in-trade, £642 15s.; Fixtures and Fittings, £89; Cash at Bank, £153; Sundry Debtors, £421 10s.; Machinery and Plant, £981; Sundry Creditors, £1,209 15s.

During the year Robert Webber withdrew from the business, for private purposes, the sum of £480.

On December 31st, Webber's financial position was as follows :—

Machinery and Plant, £1,350 10s.; Fixtures and Fittings, £80 10s.; Sundry Debtors, £732; Stock-in-trade, £950 10s.; Cash in hand, £15; Bank Overdraft, £500; Sundry Creditors, £1,400 10s.

From the above particulars, prepare a Statement showing the profit made by Webber for the year ended December 31st. When preparing this statement, no depreciation need be written off any of the assets, and no provision for Bad and Doubtful Debts is necessary. (*London Chamber Commerce.*)

7. You are instructed by T. Jones, who keeps his books by single entry, to prepare a Profit and Loss Account of his business for the year ended September 30, 1911, together with a Balance Sheet as on that date.

Upon analysing the Cash Book for the year, you find the following, viz. :—

Bank Overdraft at October 1, 1910, £800; Interest on above and Bank

Charges, £15; T. Jones's Drawings, £400; Manager's Salary, £200; Salaries and Wages, £1,500; Other Business Expenses, £1,585; Paid to Trade Creditors, £3,000; Balance at Bankers, September 30, 1911, £485; Balance in hands of Cashier, September 30, 1911, £15; Received from Trade Debtors, £5,000; Received from Cash Sales, £3,000.

T. Jones's Capital at October 1, 1910, was £7,000.

His Stock on hand on October 1, 1910, was £1,800, and on September 30, 1911, £2,044; his Creditors on October 1, 1910, £1,600, and on September 30, 1911, £1,100; his Debtors on October 1, 1910, £4,400, and on September 30, 1911, £6,000; his Furniture on October 1, 1910, £200, and on September 30, 1911, £200; his Business Premises on October 1, 1910, £3,000, and on September 30, 1911, £3,000.

You are to allow 5 % interest on the balance of Capital at October 1, 1910, to reserve £300 for Doubtful Debts, and to charge 5 % Depreciation on Business Premises and Furniture.

In addition to the £200 salary already paid to the manager, he is entitled to a commission of 5 % upon the net profits, after charging such salary and commission.

Make provision for this commission, and prepare the accounts as instructed. (*Chartered Accountants.*)

Chapter II

SELF-BALANCING LEDGERS

Definition.—In the usual course, as the student is aware, the compensating double entry for a ledger posting is contained in some subsidiary book, e.g. in a personal ledger account, goods debited are offset by a compensating credit in the Sales Journal, and cash credited by a debit in the Cash Book, and so on. The term self-balancing ledger, on the other hand, expresses the fact that the double entry has been completed *within the ledger itself*. The obvious corollary to this procedure is that the extraction of all the balances from that particular ledger will result in a Trial Balance proving the arithmetical accuracy of the posting of the ledger at any chosen date.

Procedure.—To achieve the result indicated above, every debit appearing in the accounts in a particular ledger is duplicated by a credit, and every credit by a debit, in an *Adjustment Account*, usually kept at the end of the ledger. The Adjustment Account thus contains a summary, in totals, of all the detailed debits and credits appearing in the individual accounts in the ledger. It will be clear, therefore, that the balance of the Adjustment Account should be equal, and opposite, to the net difference between all the other balances.

In addition to proving the arithmetical accuracy of the postings, the Adjustment Account is also useful, inasmuch as it enables the total of the balances contained in a ledger to be quickly ascertained without the labour of extracting all the individual balances. In other words, it readily shows the total debtors and creditors on that particular ledger at any desired date.

The system described is usually adopted where a business has more than one Sales or Bought Ledger. In cases where the ledgers are numerous, the search for a " difference in the books " may well prove long and tedious. If the ledgers are " self-balancing," the error can be localised in the particular ledger which is at fault, and much time is thereby saved.

The system is also frequently used in cases where the Private Ledger is written up periodically by one of the partners, or the firm's accountants, and it is desired to extract a Trial Balance without disclosing the contents of the Private Ledger to the office staff. A figure can be supplied for incorporation in the general Trial Balance representing the net result of all the balances contained in the Private Ledger.

The principle involved in these accounts is identical with that

employed in "Total Debtors" or "Total Creditors" Accounts, which are operated as follows:—

Assume a business with one Sales Ledger and one Bought Ledger. By means of analysis columns in the Cash Book, the total cash posted to the debit, or credit, of the individual personal accounts in the Bought and Sales Ledgers can be conveniently collected and posted in periodical *totals* to the debit or credit of the "Total Accounts." Thus cash received from customers would be posted *in detail* to the credit of their personal accounts in the Sales Ledger, and, at the end of the month, quarter, or other period, the Sales Ledger column in the Cash Book would be posted *in total* to the "Sales Ledger Total Account," or "Total Debtors' Account."

Discount, Sales, Purchases, Returns, etc., would be similarly treated by the provision of analysis columns where necessary. Any items posted from the Journal, such as bad debts, contras, etc., would also be dealt with twice, viz. once in the Sales or Bought Ledger (Personal Account), and once in the Private Ledger (Total Account). Thus the Total Debtors' Account would contain, *in total*, all the items debited or credited *in detail* in the Sales Ledger, and, in extracting a Trial Balance, the figure on the Total Debtors' Account would be included. The accuracy of the Sales Ledger balance would be proved by its agreement with the Total Debtors' Account balance.

TRANSFER JOURNAL.

Date.	Particulars	Folio.	Debits.					Credits.					Folio.
			Sales Ledgers.			Bought Ledgers.		Sales Ledgers.			Bought Ledgers.		
			A–K.	L–R.	S–Z.	A–M.	N–Z.	A–K	L–R.	S–Z	A–M.	N–Z.	
			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	
19.. May 1	Robinson, Contra..	R2					20 0 0		20 0 0				R7
May 7	Steinbaum, changed name to Brown	B6	50 0 0							50 0 0			S3

This method involves what may be termed "triple entry," since cash received, for example, is credited to the personal account of the debtor, debited in the Cash Book, and also credited in the Total Debtors' Account. It may be that it was the desire to complete the double entry, even though it involved "quadruple entry" that led to the raising in the Subsidiary Ledger of an Adjustment Account similar to the Total Account in the Private Ledger, but compensating the latter account in that it contained the same items but on the opposite sides.

Construction of Adjustment Accounts.—Adjustment Accounts are raised in the following manner:—

The Purchase and Sales Journals, and other subsidiary books, and the Cash Books, are posted in detail to the Sales or Bought Ledgers in the usual way. Periodically (e.g. every six months) these subsidiary books are analysed so as to show the total debits and credits posted to each individual Sales or Bought Ledger. The various totals of the items debited to any Sales or Bought Ledger are then credited to the Adjustment Account contained in that ledger, and are debited to the Adjustment (or Control) Account in the General (or Private) Ledger. For example, the entries in the Sales Journal will be posted in detail to the personal accounts in the Sales Ledger, and the total will be credited to the Sales Account in the General Ledger. This total will then be journalised as follows:—

Sales Ledger Adjustment Account Dr.
(the account in the General Ledger).
To General Ledger Adjustment Account
(the account in the Sales Ledger).
For credit sales for the period.

The totals of all the subsidiary books will be similarly treated, and it is essential that all items must first pass through a book of original entry. But if all the subsidiary books, and the Cash Book, are provided with analysis columns, as they should be, the periodical analysis will not, of course, be necessary. Transfers between different Sales or Bought Ledgers must first be recorded in a Transfer Journal ruled as shown on p. 9 (assuming that three Sales Ledgers and two Bought Ledgers are employed).

It is not considered necessary to show rulings of the other subsidiary books with analysis columns, since these take the ordinary form with analysis columns added for the several ledgers to which the detailed items are posted.

Alternative Methods :—

(*a*) The items in each book of original entry may be analysed. This involves some method of distinguishing the items posted to the various ledgers. If, say, there are three Sales Ledgers, they could be allotted code letters, e.g. A, B, and C. In posting to the

ledgers, the clerk would insert the code letter as well as the folio of the account to which the item was posted. Or, when checking the postings, different coloured inks could be used for the various ledgers, thus facilitating periodical analysis.

(*b*) Separate books of original entry and Cash Books can be used for each ledger. This is a further extension of the analysis column, or tabular system. Thus, all cash received from customers in the A Sales Ledger would be entered in the A Sales Ledger Receipts Cash Book; all sales to A Ledger customers in the A Sales Journal, etc.

(*c*) Where posting is effected by machine, the total of one batch of postings made to one set of Ledger cards, obtained from the strip, is printed on the control card. There are several variations of this method, which is, perhaps, the only practicable one where the personal ledgers are very numerous, e.g. 100 or more, as there sometimes are!

Illustration.—The following is an example of a Sales Ledger Adjustment Account as appearing in the General Ledger, and the General Ledger Adjustment Account as kept in the Sales Ledger.

Dr. SALES LEDGER ADJUSTMENT ACCOUNT. Cr.

			£	s.	d.				£	s.	d.
19... Jan. 1	To Balance brought down		6,216	10	7	19... Jan. 1	By Balance brought down		43	6	8
June 30	,, Sales		12,470	3	4	June 30	,, Cash		11,760	2	1
,, 30	,, Cash		17	2	2	,, 30	,, Discount		211	3	0
,, 30	,, Balance carried down		50	4	6	,, 30	,, Bills Receivable ..		70	0	0
						,, 30	,, Returns..		196	0	10
						,, 30	,, Contras		22	0	0
						,, 30	,, Bad Debts		15	2	6
						,, 30	,, Balance carried down		6,436	5	6
		£	18,754	0	7			£	18,754	0	7
19... July 1	To Balance brought down		6,436	5	6	19... July 1	By Balance brought down		50	4	6

Dr. GENERAL LEDGER ADJUSTMENT ACCOUNT. Cr.

			£	s.	d				£	s.	d.
19... Jan. 1	To Balance brought down		43	6	8	19... Jan. 1	By Balance brought down		6,216	10	7
June 30	,, Cash		11,760	2	1	June 30	,, Sales		12,470	3	4
,, 30	,, Discount		211	3	0	,, 30	,, Cash		17	2	2
,, 30	,, Bills Receivable..		70	0	0	,, 30	,, Balance carried down		50	4	6
,, 30	,, Returns		196	0	10						
,, 30	,, Contras		22	0	0						
,, 30	,, Bad Debts		15	2	6						
,, 30	,, Balance carried down		6,436	5	6						
		£	18,754	0	7			£	18,754	0	7
19... July 1	To Balance brought down		50	4	6	19... July 1	By Balance brought down		6,436	5	6

EXAMINATION QUESTIONS.

1. From the following particulars prepare the Bought Ledger Adjustment Account as at March 31, 19.., as it should appear in the General Ledger, and bring down the balance :—

March 1st. Total Creditors' Balance, £6,261 10s. 6d. March 31st. Purchases, £17,767 14s. 4d.; Discounts Received, £133 10s. 7d.; Transfer to Credit of Sales Ledger Account, £76 5s. 9d.; Bills Payable, £400; Returns, Outwards, £12 10s. 4d.; Cash Paid, £15,534 11s. 2d. (*Incorporated Secretaries.*)

2. From the following particulars prepare the Sales Ledger Adjustment Account as it will appear in the General Ledger for the month ended May 31, 19.. :—

May 1st, Balances, £5,000; Sales, £38,000; Returns Inwards, £150; Cash Received, £36,850; Bills Receivable, £2,000; Bad Debts, £60; Allowances made to Customers, £10; Bills Receivable, dishonoured, £140; Contra Accounts in Bought Ledger transferred, £370. (*Institute of Book-keepers.*)

3. A limited company has in operation a system of sectional balancing in regard to its Sales Ledgers, five in number, as a whole.

You are requested to advise as to any changes necessary or desirable in the accounting system which will, by analysis of the transactions, enable each of these ledgers to be separately balanced. Give your advice accordingly. (*Chartered Accountants.*)

4. From the following particulars prepare the General Ledger Adjustment Account in the Sales Ledger, as at September 30, 19.., and bring down the balance :—

Sales, £17 000; Bills Receivable, £60; Returns, £195; Bad Debts, £75; Dishonoured Bill, £860; Cash Received, £13,020; Discounts, £40; Transfers from Bought Ledger Contra Accounts, £1,970; Opening Debtors, £1,140. (*Incorporated Secretaries.*)

5. From the following particulars write up the Bought Ledger of G. Rosser, and agree the list of balances as on July 31, 19.., by preparing a Bought Ledger Adjustment Account :—

Credit Balances, July 1, 19.. : J. Smithson, £84 17s. 2d.; A. Robinson, £193 6s. 8d.; D. Dickinson, £14 11s. 7d.; T. Johnson, £72. Debit Balance, July 1, 1917 : G. Williamson, £15 10s.

19.., July 2nd : Purchased goods from A. Robinson, £124 5s. 9d. July 3rd : Purchased goods from T. Johnson, £57 4s. 6d.; Received cash from G. Williamson for returns, £15 10s. July 5th : Paid J. Smithson, £82 14s. 9d.; Discount allowed by him, £2 2s. 5d.; Goods returned to T. Johnson, £27 11s. July 6th : Purchased goods from D. Dickinson, £185. July 9th : Accepted D. Dickinson's draft at three months, £150; Paid him, £49 11s. 7d. July 12th : Paid A. Robinson on account, £96; Discount allowed by him, £4; Paid T. Johnson, £101 13s. 6d. July 16th : Purchased goods from T. Johnson, £88 6s. 5d.; Purchased goods from D. Dickinson, £217 4s. 11d. July 25th : Paid D. Dickinson on account, £57 4s. 11d. July 31st : Purchased goods from A. Robinson, £43 8s. 2d.; Returned goods to D. Dickinson, £13 13s. 8d. (*Chartered Accountants.*)

6. From the following particulars prepare the Sold Ledger Adjustment Account in the General Ledger for the month ended July 31, 19.. :—

Sold Ledger.—July 1, 19.., Debit Balances, £3,000; Sales, £32,000; Returns Inwards, £120; Cash Received, £26,930; Bills Receivable, £2,000; Bad Debts, £180 Bills Receivable dishonoured, £150; Discount allowed to Customers, £60; Contra Accounts in Bought Ledger transferred, £400. (*Institute of Book-keepers.*)

Chapter III

TRADING, MANUFACTURING, AND PROFIT AND LOSS ACCOUNTS

I. Trading and Manufacturing Accounts.

As the student is aware, when an agreed Trial Balance has been extracted from a set of books at the close of a financial period, the next step is to ascertain the trading results achieved. Occasionally, this is done by preparing a single Profit and Loss Account, but more frequently by dividing the account into two or more sections in order to show : (*a*) the *gross* profit or earnings, and (*b*) the real or *net* profit for the period.

Frequently, a third section is added which shows how the net profit for the period has been appropriated. It is essential in a manufacturing business, if an efficient check upon the manufacturing process is to be maintained, to show the gross profit earned by manufacture.

Construction.—Answers to examination questions calling for the preparation of a set of accounts from the ledger balances and information given always reveal differing figures of gross profit ; and it must be admitted that in the commercial world also scant uniformity is observable in the apportionment of the various charges as between gross and net profit. In the absence of definite instructions, and in view of the debateable points in this connection, the student will be wise to confine his Trading or Manufacturing Account to those items which directly affect the prime cost of purchasing or producing the articles sold, and to deal with all selling, distribution, and overhead charges in the Profit and Loss Account.

By *Prime Cost* in this connection is meant :—

(*a*) In a non-manufacturing concern, the balance of an account wherein, on the debit side, appears (*a*) Initial stock ; (*b*) Net purchases, i.e. *less* returns ; (*c*) Warehouse wages and expenses ; (*d*) Carriage inwards ; and, on the credit side, (*e*) Sales (net) and (*f*) Final Stock. Items which do not vary directly with the sales should be excluded. An account prepared on these lines will show the ratio which the gross earnings bear to sales.

(*b*) In a manufacturing concern, the account should include, on the debit side, (*a*) Initial stock and work in progress ; (*b*) Raw materials purchased (net) ; (*a*) Factory wages and expenses and

factory manager's salary; (*d*) Carriage inwards; (*e*) Factory power, lighting, heating, rent, and rates; and, on the credit side, (*f*) Sales (net); (*g*) Final stock and work in progress.

Where the information given in an examination question indicates that other charges are divisible between manufacture and distribution, suitable apportionments must, of course, be made, as explained on p. 27.

Basis Must be Consistent.—The most important information furnished by a series of Trading or Manufacturing Accounts is the ratio of gross profit between period and period. It is, therefore, *essential* that the account should be constructed upon a consistent plan, otherwise comparisons will be valueless. In the absence of exceptional circumstances, the ratio of gross profit should not vary, except within narrow limits. If wide fluctuations in the ratio of gross profit to turnover should occur, immediate investigation should follow, since such fluctuations may arise from defalcation, pilfering, faulty buying, or inaccurate stock valuations.

Non-Manufacturing Concerns.—Where all goods are purchased ready for sale, and no manufacturing is done, the construction of the Trading Account usually follows the simple lines indicated above, and illustrated in the solution on p. 17. This form of account, if consistently adhered to, will, in most cases, enable the necessary comparisons to be made, more particularly the ratio between gross profit and sales. It is true that the Trial Balance will probably contain items that do not enter into the cost of the goods, e.g. depreciation. Such charges do not, however, move in sympathy with the turnover, and, unless he is instructed to the contrary, the examination candidate will be wise to confine them to the Profit and Loss Account.

Manufacturing Concerns.—In a manufacturing business, the Working or Manufacturing Account usually contains much more detail than the Trading Account dealt with above. The actual cost of the goods sold by a merchant is fixed by his invoices, but the manufacturer can ascertain the cost of his goods only by careful accounting.

(*a*) In the majority of cases, manufacturers prepare a combined Manufacturing and Trading Account. This deals with the costs of manufacture and the resulting sales. But accounts in this form fail to show the actual manufacturing profit.

(*b*) In other cases, a Manufacturing Account is prepared which is strictly confined to ascertaining the actual cost of the goods made, without reference to the current market price of similar goods. Then the account shows neither profit nor loss, and the balance, representing cost, is transferred to a Trading Account which includes sales and the relative distribution costs. The balance of this account is then carried to a Profit and Loss Account, in which the net profit for the period is determined.

(c) In yet other cases, the Manufacturing Account is charged with all costs of production on the usual lines, and is credited, at current market values, with the goods produced. The resulting balance shows the manufacturer's factory profit or loss on the basis of current market prices. The goods made are debited to the Sales Department at the current market price just as though they had been purchased from outside sources. The results shown by both the manufacturing and sales departments are finally transferred to the Profit and Loss Account.

Blankshire Blast Furnaces, Limited.

MANUFACTURING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr. Cr.

	£	s.	d.		£	s.	d.
To Materials consumed * :— (£ s. d.)				By Sales :— (£ s. d.)			
Coal (including carriage) .. 6,420 10 2				Slag (net) .. 4,604 1 2			
Coke (including carriage) .. 17,924 1 1				Sand 141 11 10	4,745	13	0
Limestone .. 1,621 0 4				" Wagon Hire (sublet)	321	0	10
Ironstone .. 6,352 8 9				" Pig Iron produced, transferred to Trading Account (cost per ton, 37s. 5½d.)	34,457	7	7
Sundry Materials 281 4 6	32,590	4	10				
" Manufacturing Wages	5,762	12	6				
" Salary, Works Manager	1,000	0	0				
" Land Damages and Compensation..	162	4	1				
£	39,524	1	5	£	39,524	1	5

TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr. Cr.

	£	s.	d.		£	s.	d.
To Stock of Pig Iron at this date (cost per ton, 35s. 6½d.) ..	8,122	10	0	By Sale of Pig Iron (£ s. d.) 50,851 14 6			
" Cost of Pig Iron produced as per Manufacturing Account ..	34,457	7	7	*Less* Short Weight claims 841 10 2	50,010	4	4
" Sundry Trade Charges and Sale Expenses	6,220	8	6	" Pig Iron consumed in Foundry	92	10	0
" Balance carried to Profit and Loss Account	12,284	3	11	" Stock of Pig Iron	10,981	15	8
£	61,084	10	0	£	61,084	10	0

* The practice in accounts of this kind is to debit and credit the initial and final stocks of coal, limestone, and other raw materials, in the Nominal Ledger Accounts, transferring the balances only of such accounts to the Manufacturing Account as representing the *net* cost of each item.

The divisions and appropriations in accounts of this description are frequently not very scientifically made. But if they suit the manufacturer's requirements, and the accounts are consistently prepared period by period, they will furnish material for the necessary comparisons. An example of a set of accounts prepared on lines set out in (b) is shown above, and a set prepared on lines set out in (c) above, on p. 16.

In a business where an efficient costing system is installed, the costing records govern the construction and division of the different sections of the Manufacturing, Trading, and Profit and Loss Accounts,

MANUFACTURING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr. Cr.

	£	s.	d.		£	s.	d.
To Stock at commencement :—				By Stock at close —			
Raw Materials	2,100	0	0	Raw Materials ..	3,100	0	0
Partly Manufactured Goods	3,600	0	0	Partly Manufactured Goods	4,700	0	0
	5,700	0	0		7,800	0	0
„ Purchases of Raw Material (*less* Returns)	21,263	0	0	„ Amount transferred to Trading Account, being trade price of finished goods	66,871	0	0
„ Manufacturing Wages	25,512	0	0				
„ Factory Power	2,240	0	0				
„ Carriage Inwards on Raw Materials	567	0	0				
„ Factory Expenses	7,276	0	0				
	62,558	0	0				
„ Balance carried to Profit and Loss Account, being gross profit on manufacturing ..	12,113	0	0				
£	74,671	0	0	£	74,671	0	0

TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr. Cr.

	£	s.	d.		£	s.	d.
To *Stock of finished goods at commencement*	10,216	0	0	By Sales (*less* Returns)	88,473	0	0
„ Manufacturing Account (trade price of goods manufactured)	66,871	0	0	„ Stock of finished goods at close	11,109	0	0
„ Purchases of Finished Goods (*less* Returns)	526	0	0				
„ Packing and Distribution Expenses	9,267	0	0				
	86,880	0	0				
„ Balance carried to Profit and Loss Account, being Gross Profit on Sales	12,702	0	0				
£	99,582	0	0	£	99,582	0	0

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr. Cr.

	£	s.	d.		£	s.	d.
				By Gross Profit on Manufacturing	12,113	0	0
				„ Gross Profit on Sales	12,702	0	0
				£	24,815	0	0

thus enabling approximate reconciliation to be made between the costing and the financial records. It will be clear that in this case many charges normally dealt with in the Profit and Loss Account

PERCENTAGE TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr. | Cr.

	Percentage on Sales.	£	s.	d.		Percentage on Sales	£	s.	d.
To Stock	28·20	5,640	0	0	By Sales (net)	100·00	20,000	0	0
" Purchases (net)	64·81	12,962	0	0	" Stock	24·25	4,850	0	0
" Carriage Inwards	4·75	951	0	0					
" Balance carried to Profit and Loss Account, being Gross Profit for the year	26·49	5,297	0	0					
	124·25	£24,850	0	0		124·25	£24,850	0	0

COMPARATIVE TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr. | Cr.

	Percentage on Sales. 19...	Percentage on Sales. 19...	£	s.	d.		Percentage on Sales 19...	£	s.	d.
To Stock	—	—	12,500	0	0	By Sales (net)	100·00	56,000	0	0
" Purchases (net) *	49·21	50·78	37,500	0	0	" Stock	—	21,560	0	0
" Manufacturing Wages	23·71	22·67	12,700	0	0					
" Factory Power	6·01	5·73	3,210	0	0					
" Balance, being Gross Profit for the year, carried down	21·07	20·82	11,650	0	0					
	100·00	100·00	£77,560	0	0		100·00	£77,560	0	0

* The percentages shown against this item represent net materials consumed.

section will be transferred to the Manufacturing or Trading Account sections, otherwise the costing and financial records will not harmonise. Accounts thus prepared will show, as near as may be, the actual manufacturing cost of the articles produced. As a general rule, the cost so ascertained is brought forward as a debit to the Trading Account section, as representing the cost of the goods handed to the trading department for sale. If it is desired to ascertain the actual manufacturing profit secured, the goods handed over, and any stocks remaining wholly or partially finished, must be valued at the current market prices ruling for manufactured goods of similar kind. This procedure will produce a figure representing manufacturing profit apart from trading profit. A corresponding debit must, of course, be made in the Trading Account section.

Percentage and Comparative Trading Accounts.—It is customary and useful in some businesses to prepare Trading or Manufacturing Accounts with one or more additional columns to accommodate percentage figures showing the proportion which the expense figures bear to the turnover for the year, or a series of past years. These percentages are frequently very informative, and are more expressive than variations shown in sterling values. An increase of turnover is naturally accompanied by increases in such expenses as move in sympathy with it, and they should be in a fixed ratio to the turnover. But *fixed* charges should not as a rule increase. Increases in gross profit percentages are, of course, satisfactory if they arise from cheapened raw material, reduced expenses, or better selling prices, but care must be taken that they do not arise from inflated stock valuation. Such accounts are illustrated on p. 17.

Ess and Aye Modes, Limited.

DR. DEPARTMENTAL TRADING ACCOUNT FOR THE

		Mantles.			Furs.			Tweeds.			Total.		
19...		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
Jan. 1	To Stock	2,000	0	0	5,000	0	0	1,500	0	0	8,500	0	0
Dec. 31	" Purchases (net)	7,860	0	0	22,080	0	0	5,160	0	0	36,000	0	0
" 31	" Warehouse Wages ..	3,186	0	0	4,840	0	0	1,850	0	0	9,876	0	0
" 31	" Salaries and Commission	1,215	0	0	2,710	0	0	1,501	0	0	5,432	0	0
" 31	" Heating and Lighting ..	241	0	0	740	0	0	280	0	0	1,261	0	0
" 31	" Rent and Rates	1,000	0	0	2,000	0	0	800	0	0	3,800	0	0
" 31	" Balance carried to Profit and Loss Account ..	1,258	0	0	3,125	0	0	1,101	0	0	5,484	0	0
		£16,760	0	0	£41,401	0	0	£12,192	0	0	£70,353	0	0

The student will realise that no stereotyped forms can be laid down for Trading and Manufacturing Accounts. Great divergency exists even in the same industry (with the possible exception of the brewing industry), and the preferences and requirements of the individual

manufacturer frequently determine the precise form that these accounts shall take. So few companies publish these accounts that the student has little opportunity of inspecting an assortment of " live " accounts of the kind, but a series will be found in the author's *Accounting*, at pp. 24–32, to which the student who desires to pursue the subject further is referred.

Parliamentary Companies.—Companies governed by Statute must perforce employ the statutory forms of Working or Trading Accounts prescribed for the purpose. Examples of such accounts will be found in Chapter XIII dealing with the double-account system.

Departmental Trading Accounts.—Where a business deals in several classes of goods, handled by separate departments, it is customary to prepare the Trading Account on departmental lines as shown below.

YEAR ENDED DECEMBER 31, 19... Cr.

		Mantles.			Furs.			Tweeds.			Total.		
		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
19... Dec. 31	By Sales (net)	14,980	0	0	35,401	0	0	10,960	0	0	61,341	0	0
" 31	" Stock on hand	1,780	0	0	6,000	0	0	1,232	0	0	9,012	0	0
		£16,760	0	0	£41,401	0	0	£12,192	0	0	£70,353	0	0

In the preparation of a Departmental Trading Account, as here illustrated, some figures will result from Nominal Ledger Accounts opened for each department, to which direct postings can be made of purchases, expenses, and sales, obtained by analysis where separate Day Books are not kept for each department. In other cases the items debited will result from the apportionment of various charges, such as rent, rates, heating, etc., upon some equitable basis. These matters are more fully dealt with in Chapter XIV.

When preparing trading accounts, certain matters may arise which require special treatment. Amongst these, the following may be mentioned :—

Goods on Approval.—If the " Sale or Return " transactions are numerous, a special Sales Journal should be kept to record them. A convenient ruling will be found on p. 20.

No items are posted to the Ledgers until an actual sale takes place. The amounts finally extended into the Sales column are posted in detail to the personal accounts of the purchasers, and, in monthly or

SALES (ON APPRO.) JOURNAL.

Despatches.					Returns.						Sales.				Remarks.
Date.	Details.	Amount.			Date.	Details.	Amount.				Posting Folio S.L.	Amount.			
		£	s.	d.			£	s.	d.			£	s.	d.	

PACKAGE STOCK ACCOUNT.

Dr. Cr.

		Quantity.	Value. £	s.	d.			Quantity	Value. £	s.	d.
	To Cash at 1s. each	1,000	50	0	0		By Package Trading Account at 1s. each..	300	15	0	0
							,, Balance carried down at 1s. each.. ..	700	35	0	0
		1,000	50	0	0			1,000	50	0	0
	To Balance brought down at 1s. each ..	700	35	0	0						

PACKAGE TRADING ACCOUNT.

Dr. | Cr.

	Quantity.	£	s.	d.		Quantity.	£	s.	d.
To Sundry Debtors (per Sales Returns) at 1s. 6d. each	1,500	112	10	0	By Sundry Debtors (per Sales Day Book) at 2s. 6d. each	2,000	250	0	0
,, Package Stock Account (packages sold) at 1s. each	300	15	0	0					
,, Balance carried down. Returnable packages in hands of customers at 1s. 6d. each	200	15	0	0					
,, Profit and Loss Account:— Profit on Hire, 2,000 at 1s. each .. .. £100 0 0 Profit on Sales, 300 at 6d. each 7 10 0		107	10	0					
	2,000	£250	0	0		2,000	£250	0	0
					By Balance brought down	200	15	0	0

Note.—It is assumed that packages cost 1s. each, are invoiced to customers at 2s 6d. each, and, if returned within 7 days, are credited at 1s. 6d each. Quantity columns in the Sales Day Book, Sales Returns Book, and Sales Ledger enable the total accounts to be raised.

STOCK BOOK OF MANTLE FACTOR.

Date.	Received.								Date.	Sold.						Remarks.
	Style No. and Mark.	Quantity.	From whom Purchased (Name and Address).	Cost Price.			Manufacturer's			Purchaser (Name and Address).	S.J. Folio.	Quantity.	Sale Price.			
				£	s.	d.	Style No.	Marks.					£	s.	d.	

other totals, to the Sales Account. At stock-taking periods, the balance of goods still out on approval should be taken into stock at *cost*, or market price.

If, as is the case in some businesses, goods on appro. are treated as ordinary sales until returned, the amount of such outstanding "appro." sales must be deducted from the total sales for the period, and from the total "Sundry Debtors," and added to the stock valuation as explained above. In some cases traders handle goods received "on appro." from wholesalers. Care is needed to ensure that such goods are not taken into stock, and the best method of preventing this is to segregate all "appro." goods before stock is taken. Special records of the receipt and sale of "appro." goods must be kept, especially as in some cases the trader is under obligation to purchase the goods, if kept beyond a certain time limit. When such goods are sold, an invoice should be obtained and passed through the Purchases Book in the ordinary way.

Goods on Consignment.—These transactions should be treated in a similar way to goods sent out on approval, and be taken into stock at cost or market price, care being exercised to ensure that they have not been included with ordinary sales. In the reverse direction, care must be taken that goods received on approval, or on consignment, are not taken into stock until the actual property in them has been acquired. Goods out on consignment are preferably stated separately in both Trading Account and Balance Sheet.

Forward Invoices.—Where it is the practice to invoice goods forward, care must be taken to ensure that goods have not been taken into stock when the relative invoices have not been entered in the Purchases Journal. The correct treatment is to include such transactions in both Purchases and Stock as the property in them has passed.

Packing Materials.—Where packages are numerous and costly, it is a common practice to keep record of them in special columns added to the Sales, and Returns Inwards Journals, and the Sales Ledger, a corresponding "Packing Materials Account" being opened in the Nominal Ledger. In this way, each customer is debited (from the Sales Journal) with packing materials when goods are despatched to him, and credited (through the Returns Inwards Book) when he returns the empties. The total of the packing materials column in the Sales Journal is posted to the credit of "Packing Materials Account," and the total of the Returns Inwards column is debited to the same account. Thus efficient check is kept upon an important item, which, if loosely dealt with, will lead to inaccurate accounting. Sometimes all records relating to packages are recorded on cards, and do not appear in customers' accounts of goods sold.

Where the original cost of packing materials is heavy, it is preferable to deal with the item in the Trading Account. If no charge is made for packing, the item should appear as a distribution cost in the Profit

and Loss Account. Where crates, barrels, cases, etc., are charged to customers at a figure above cost, and an allowance less than the amount charged is made on return, it is advisable to open a Package Trading Account and credit it with all packages charged out, debiting it with all returns. The cost of packages purchased is debited to a Package Stock Account, which is credited with the cost of packages retained by customers and paid for, a corresponding debit being made to Package Trading Account; the latter account, after carrying down as a credit balance the contingent liability represented by returnable packages, shows the profit on hire and sale of packages. The packages in stock should be depreciated either by crediting a Depreciation Account, or by valuing the stock at a figure lower than cost. See illustration on p. 21.

Carriage.—Sometimes the carriage incurred in conveying to the works new machinery and plant, or similar assets, is charged to the asset account. In certain circumstances this is permissible, provided the item is written off with reasonable promptitude. When an examination trial balance contains the items "Carriage Inwards" and "Carriage Outwards," it is an indication that the former item is to be charged to the Trading Account and the latter to Profit and Loss Account.

Wages and Salaries.—It frequently happens that the close of a financial year does not synchronise with the end of a week. It is then necessary, particularly in a manufacturing business, to ascertain and pass through the books the wages and salaries accrued due from last pay day to the date of closing the books. This information can be obtained from the wages books or pay rolls. The same remarks apply to commission due to travellers and others.

Stock-in-Trade.—Inaccurate stock valuations will affect the accuracy of the trading results shown by the accounts. The stock sheets should be prepared under the supervision of responsible officials, who should fix the valuation prices of the goods. All calculations and quantities should be cross-checked by two or more persons. Stock stored in bulk in stacks or otherwise, such as coal, coke, mineral ores and the like, is generally valued by measurement. The calculations should be checked by competent persons. Record should be kept of all goods added to, or withdrawn from, bulk, and this, if accurate, will afford a check upon the stock-taking valuation. Care must be taken that no goods are taken into stock, the invoices for which have not been passed through the books, or which have been sold and charged up, but not delivered. On the other hand, it is necessary to include in the stock all goods which have been included as purchases and have not yet been sold, particularly where the goods are in outside warehouses or wharves, or in transit, at the date of stock-taking.

The basis of stock valuation *must* be consistent from year to year, otherwise comparisons of trading results will be useless, since the

profits of one period may be inflated at the expense of the succeeding period. Values should be based (*a*) upon cost price, less allowances for damaged, unpopular, or obsolete stock; or (*b*) upon market prices, if these appear to have fallen permanently below cost price. If market price is higher than cost, it is clearly dangerous to base the valuation on market price, unless one is assured that the superior market price will be maintained. Raw materials are frequently valued upon the average cost during the year.

The only legitimate departure that can be made from the cost basis of valuation occurs in some few trades, e.g. the wine and spirit and timber trades, where stocks held for future sale increase in value as they mature in quality. Most wines improve with age, and a conservative addition, representing a percentage on cost, may, therefore, be added to the original cost from period to period, provided that the valuation never exceeds the price at which wine of the same vintage and age can be purchased in the market.

In manufacturing businesses, where a proper costing system is employed, the Stores Books, Bin or Locker Cards, and similar records are of the greatest assistance for stock-taking purposes, as is explained in Chapter XV. In non-manufacturing businesses, proper stock books should be employed, suitable for the particular needs of the business. An example of a Factor's Stock Book is shown on p. 21, recording the receipt and issue of goods. This record affords a check upon stock, and greatly facilitates stock-taking, besides affording useful information as to the popularity or otherwise of any particular line which has been purchased. Separate Stock Books are frequently kept for each department or class of goods dealt in.

Work in Progress.—Manufacturing, or contracting businesses will usually have at the close of the year a certain amount of work in hand, which will not be completed till the next financial year. The valuation of "work in progress" requires the utmost care. In some cases the value of the work taken credit for in the Trading Account should not exceed its actual cost, i.e. the cost of the raw materials used, wages expended thereon, and proportion of Oncost, up to the close of the financial period. In other cases, where, for example, the work is within sight of completion, and the final cost can be exactly estimated, a measure of profit may be added to the valuation, if possible contingencies are also taken into account. The accountant is necessarily largely dependent upon the technical experts for the data required to compute the cost of completing unfinished work.

Some examination candidates appear to experience difficulty when they find included in a Trial Balance a debit balance for work in progress, and a further valuation under the same heading at the close of the period. The balance forming part of the Trial Balance should be debited to the Manufacturing Account immediately after the initial "Stock in hand," and the valuation at the close of the year, appearing

in the "instructions," should be credited to the same account immediately after the final "Stock in hand" and shown in the Balance Sheet.

Goods in Transit.—Goods purchased and in course of transit must be taken into stock at cost, if the invoices relating to them have been passed through the books, as they should be if the property in the goods has passed.

Trade Discount.—All trade discounts must be deducted from sales and sundry debtors. These discounts, in some trades, are very heavy, and omission to deduct them would result in a fictitious gross profit being shown.

II. Profit and Loss Accounts.

We have seen that the object of Trading and Manufacturing Accounts is to ascertain the gross profit earned upon the turnover. The balance of gross profit arrived at is then carried to the Profit and Loss Account, which, in theory at any rate, is usually confined to the management and distribution expenses and charges incurred in earning the net profit. But it must be admitted that both in commercial practice and in examination work, uniformity in this respect is conspicuous by its absence. Manufacturers, even in the same trade, are a law un o themselves in the allocation of the various items as between the Trading and the Profit and Loss Account.

It can nevertheless be asserted that the common aim of all Profit and Loss Accounts, however drafted, is to ascertain the *net profit* for the period. The following definition by an examination candidate is worthy of quotation. "Net profit is the amount available for distribution to the proprietor, partners, or shareholders of a business, after all charges that have been incurred in the earning of the revenue for the period under review have been taken into account, and the shrinkage in the value of the assets held by the business has been allowed for."

Limited companies rarely publish Trading or Manufacturing Accounts, and there is a growing tendency to publish Profit and Loss Accounts as greatly abbreviated as ingenuity can devise and the law permit. The result is that many items which, in theory, should appear in the Profit and Loss Account are charged in the Trading Account, and are thus hidden from observation. It should be remembered that, unless the form of the Profit and Loss Account is prescribed by Statute, the manner of its presentation is entirely at the discretion of the directors, and the auditor cannot impose his views unless, of course, the account it is proposed to publish is inaccurate or misleading.

The Companies Act, 1929, makes it compulsory for every company within the meaning of that Act to lay before a general meeting, at least once in every calendar year, a Profit and Loss Account (or Income and Expenditure Account, if more appropriate). This account must, unless

the Balance Sheet contains the information, disclose the total directors' fees, the rate at which interest has been paid out of capital on shares issued under S. 54 of the Act of 1929 (see p. 417), and the amount of the relevant share capital.

The particular form in which the items composing a Profit and Loss Account should be stated must of necessity vary with different businesses. It is suggested, however, particularly for costing purposes, that the following grouping is desirable :—

(*a*) *Sales Expenses.*—Salaries of Sales Staff, and Travellers; Commission; Advertising; Window Publicity; Warehouse and Store Rent, Rates and Expenses, and the general expenses of selling the goods dealt in.

(*b*) *Distribution Expenses.*—Carriage Outwards; Cartage; Freight; Expense of Motor Lorries or Vans; Wages of Drivers, Packers, Porters, and the general expenses of distribution.

(*c*) *Administration Expenses.*—Directors' Fees; Managers' and Clerks' Salaries; Office Rent; Rates and Expenses; and the general expenses of management and supervision.

To summarise on broad lines :—

(1) *Business of Factor, Merchant, or Distributor.*

(*a*) *Trading Account.*—Debit the account with the initial stock, purchases, and the cost of getting goods into the warehouse or store. Credit the account with Sales and the final stock. The balance represents *gross* profit.

(*b*) *Profit and Loss Account.*—Credit the balance of gross profit from Trading Account, discount (if a credit balance), and similar items. Debit all sales expenses, carriage of goods outward, distribution expenses, and administration expenses. The balance represents *net* profit.

(2) *Manufacturing Business.*

(*a*) *Manufacturing Account.*—Debit the account with the initial stock, purchases of materials, productive wages, rent, rates, and expenses of factory, carriage of goods inward, and every expense incurred in the production of the articles manufactured. Credit sales and final stock. The balance represents *gross* profit.

(*b*) *Profit and Loss Account.*—As in (1) (*b*).

Some difference of opinion exists as to the proper treatment of discount on Sales and Purchases. It is submitted that all *trade* discounts should be dealt with in the Trading Account, and *cash* discounts in the Profit and Loss Account. The student will be aware that it is usual to deduct trade discounts when invoicing goods, so that only *net* amounts appear in the Sales Journal—in most cases, therefore, no actual entries regarding trade discounts appear in the books. Similar diversity of opinion also exists in the treatment of carriage, and the examination candidate will be well advised to treat all *carriage inwards* in the Trading Account, and *carriage outwards*, as part of the cost of distribution, in the Profit and Loss Account.

Errors in Examination Work.—The examination candidate has been advised to confine the Trading Account to the prime cost of the articles dealt in. The items remaining in the Trial Balance, chargeable against revenue or to be added thereto, after the items appertaining to the Trading Account have been dealt with, must perforce appear in the Profit and Loss section. These items will consist mainly of distribution and management costs, items of revenue also appearing occasionally. Before the account can be closed, certain adjustments, e.g. provisions for wastage, etc., will be necessary, but these are contained in supplementary "instructions," and do not figure in the Trial Balance. Analysis of a few typical examination Trial Balances will disclose that the revenue items remaining after the preparation of the Trading Account consist chiefly of such items as: Rent, Rates, Taxes, Interest, Bad Debts, Office Expenses and Salaries, Directors' Fees, Carriage Outwards, Transfer Fees, Royalties, Legal Expenses, Travellers' Salaries and Commission, Preliminary Expenses, Discount, Insurance, Bank Charges, Advertising, Postages, Stationery, Apprentices' Premiums, Trade Expenses, etc.

In the absence of specific instructions to the contrary, the items set out above should be dealt with in the Profit and Loss Account section. Careful attention must, however, be paid to any *indication* as to the proper treatment, which may not actually be expressed in so many words. For instance:—

(*a*) If the question deals with the accounts of an engineer, and "apprentices' premiums" appear in the Trial Balance, the item should be apportioned over the period of the indentures (if mentioned in the question), and the portion applicable to the period covered by the accounts should be credited in the Manufacturing Account, since the apprentices are taught in the factory, and the factory should have credit for the fees earned.

(*b*) Again, items may appear as follows: *Rent and Rates* (*Factory*, £1,692; *Office*, £450), £2,142; *Insurance* (*Warehouse*, £345; *Office*, £80), £475. Stated in this way there is clear *indication* that the Factory (or Warehouse) and the Office are to be charged with the expense in the proportions given within the brackets. Candidates frequently ignore these indications and lose marks in consequence.

Almost without exception, an examination Trial Balance is accompanied by instructions directing various adjustments to be made before closing the Profit and Loss Account. Experience shows that more candidates come to grief through incorrectly treating these adjustments, or failing to deal with them completely, than from any other cause. It may be well, therefore, to select a few typical adjustments from actual examination questions and show where the candidates went wrong in dealing with them.

Illustration (*a*).—"The following valuations were made as on December 31, 19..: Stock, £6,892; Motor Lorries, £2,896; Loose Tools £1,700. . . . Depreciation is to be provided as follows: Plant and Machinery, 10 %; Office Furniture, 5 %."

In the Trial Balance, Motor Lorries stood at £3,420, and Loose Tools at £1,998.

Some candidates dealt correctly with the provision for depreciation on Plant and Machinery, and Office Furniture, but entirely overlooked the plain *indication* that Motor Lorries had also been depreciated (by valuation) by £524, and Loose Tools by £298. This oversight resulted in an overstatement of the net profit by £822. This is a common error.

Illustration (*b*).—"The Debenture Interest accrued due as on December 31st had not been provided for." The candidate was informed that the company had issued £20,000 5 % Debentures on January 1st, and, in the Trial Balance, £500 appeared as a debit to Debenture Interest Account. This was an *indication* that the only interest outstanding was that accrued due for the *half-year* to December 31st. Many candidates, ignoring the indication, charged the accounts with a full year's interest in addition to the debit mentioned above, i.e. with £1,500. Careless oversight of such a point as this is a common experience.

Illustration (*c*).—"Manufacturing Wages (£962) were spent in making new patterns for use in the Company's factory." "Patterns Account, £500," appeared in the Trial Balance. A number of candidates deducted £962 from the wages in the Manufacturing Account but failed to add a like sum to the asset account (Patterns), and therefore, of course, failed to "balance." This is typical of adjustments incompletely effected by candidates through dealing with one aspect only of the adjustment. Outstanding wages, salaries, directors' fees, and the like also provide fruitful examples of these one-sided adjustments, omission being made to schedule them as creditors in the Balance Sheet.

Illustration (*d*).—In the reverse direction, the treatment of revenue expenditure the benefit of which extends beyond the period covered by the accounts is equally productive of error in examination work. For example: "Insurance (Factory, £102; Office, £15), £117, is to be carried forward to next year." Some candidates made the necessary deductions from the Insurance items in the Manufacturing and Profit and Loss Accounts, but omitted to schedule the £117 as a temporary asset in the Balance Sheet as "Expenses Paid in Advance," and thus failed to "balance."

These errors would be obviated if candidates would remember that all adjustments, outside the Trial Balance, affect *both* the Balance Sheet and either the Manufacturing, Trading, or Profit and Loss Account. It is, therefore, necessary to complete the double entry by dealing with each adjustment *twice*.

Revenue Expenditure.

Revenue expenditure may be defined broadly as expenditure that does not increase the value of the fixed assets by the use of which the income of an undertaking is earned. Such expenditure consists of the cost of maintaining the fixed assets in efficient working order, the cost of manufacturing and distributing the goods dealt in, and the management expenses of the business. It is sometimes difficult to differentiate between Capital Expenditure and Revenue Expenditure. Capital Expenditure may be deemed to consist of the cost of any additions or alterations to capital assets that increase the earning power

of the business; Revenue Expenditure consists of the cost of reconstructing or rehabilitating fixed assets—ordinary replacements, renewals, and repairs of such assets. We will consider here typical items of revenue expenditure, which commonly find a place in Examination Trial Balances :—

Wages.—As already stated, the close of a financial year is not always coincident with the end of a working week. Wages accrued due since the last pay day to men employed in the distribution side of the business should be charged to Profit and Loss Account; but if wages have been paid in respect of capital expenditure, a transfer should be made from the credit of Wages Account to the debit of the particular Asset Account. Wages paid to the workmen of a firm or company for time spent upon plant and machinery installation, the making of loose tools, building extensions and the like require this treatment.

Illustration.—" Manufacturing Wages, £268, had been expended in the installation of Plant in the Company's Factory."

Here, Manufacturing Wages, in the Manufacturing Account, should be reduced by £268, and a like amount be added to the Plant account *before* provision is made for depreciation at the stated rate.

In theory, Journal entries should be made for outstanding wages and similar items. In practice, the relative Ledger account is debited with the amount accrued, and this amount is then brought down as a credit balance, and is scheduled amongst " Sundry Creditors " in the Balance Sheet.

Dr. WAGES ACCOUNT. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Cash. Wages paid to date ..	C.B. 62	5,367	0	0	19... Dec. 31	By Trading Account	P.L. 16	5,502	0	0
" 31	" Three Days' Wages accrued to date, carried down	√	135	0	0						
		£	5,502	0	0			£	5,502	0	0
						19... Dec. 31	By Balance brought down	√	135	0	0

Salaries.—Here also salaries accrued due must be provided for. The outstanding amount must be added to the Salaries item in the Profit and Loss Account and to the Sundry Creditors in the Balance Sheet. If the accounts are those of a manufacturer, the salary of the factory manager should be charged in the Manufacturing Account. In examination work, if the Factory Manager's salary is separately stated, it is an *indication* that the amount should be charged against gross profits. Partners' salaries should be separately stated in view of the requirements of Schedule D (Income Tax) as dealt with later.

Directors' Fees, etc.—The fees to which Directors are entitled will be disclosed either by the Articles of Association, or by resolution of the shareholders in general meeting, recorded in the Minute

Book; the Managing Director's salary and commission (if any), should one of the board have been appointed to act as such, will be fixed in his agreement with the company, or by a Directors' Minute; travellers' salaries and commission will be fixed by their agreements; and the auditor's remuneration usually by resolution of the shareholders.

Directors' fees, whether drawn or not, should be debited to Profit and Loss Account as a separate item; unless, of course, each individual director has definitely forgone his fees, as evidenced by a Directors' resolution. The aggregate fees paid must be disclosed in the accounts laid before the general meeting.

Needless to say, although directors may forgo fees, they have no power to charge the accounts with fees on a higher scale than that authorised by the Articles, or resolution of shareholders. In the case of a Managing Director, the amount paid, apart from his fees as a director, should be treated as salary, and not be included in the item "Directors' Fees," which should be confined to the amount allowed to the Directors by the Articles or by resolution. Limited companies are not entitled to pay income tax on Directors' fees unless specially authorised by the Articles, or by vote of the shareholders, so to do.

Examination questions frequently indicate that charges mentioned above in the first paragraph of this section are outstanding.

Illustration.—"Directors' Fees (half-year to June 30, 19..), £500." Such an extract from an examination Trial Balance indicates that candidates are required to provide for the half-year's fees, £500, July 1 to December 31, 19... Directors' Fees, £1,000, must therefore be charged in the Profit and Loss Account, and £500 must be added to the creditors in the Balance Sheet for fees due but unpaid.

Renewals and Repairs.—Renewals need very careful consideration. If they represent the installation of a new in place of an old machine, the cost may be capitalised by transfer to "Machinery and Plant Account," always provided that any balance that may remain on the old asset account, after crediting thereto the proceeds of sale of the old asset, is written off against revenue.

Very heavy repairs occur every few years in certain trades, where, e.g., powerful acids are employed in manufacture, and then it is usual and legitimate to spread the cost over those years which benefit from the outlay, thus equalising the charges against profits. The amount held in suspense is carried to a Repairs Equalisation Account (Maintenance Reserve). Sometimes an account of this kind is created by annual transfers from Profit and Loss Account of equal amount, the cost of all repairs actually executed being debited against the fund. The annual contributions to the fund are determined by the actual expenditure upon repairs incurred in past years. If this practice is adopted, care must be taken that the fund is in credit at the close of the financial period. Should the fund be in debit, it will be obvious that the annual contribution needs to be increased, unless the deficit is due to

abnormal circumstances, which will adjust themselves in the near future.

A fund of the kind is useful where it is known that, in later years, particular assets will demand heavy repair expenditure, or where the repairs will be irregular in their incidence. In such cases, an estimate of the repair cost for the whole "life" of the asset or assets should be made, an equal proportion of which should then be charged against the Profit and Loss Account for each year of the assumed "life" of the asset or assets.

Building Renewals and Repairs.—These are governed by the same considerations as outlined above. Unless they permanently increase the value of the property, or add something which was not there before, all repairs and renewals should be charged against revenue.

The operation of a Repairs Equalisation Account is shown in the following accounts :—

PROFIT AND LOSS ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Repairs Equalisation Account (annual instalment)	250	0	0				

REPAIRS EQUALISATION ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Transfer from Repairs Account..	210	0	0	By Profit and Loss Account	250	0	0
" Balance carried down	40	0	0				
	£250	0	0		£250	0	0
				By Balance brought down	40	0	0

REPAIRS ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Cash. Cost of Repairs for the year	210	0	0	By Transfer to Repairs Equalisation Account	210	0	0
	£210	0	0		£210	0	0

BALANCE SHEET.
(Liabilities Side.)

	£	s.	d.
Repairs Equalisation Account	40	0	0

Machinery Repairs.—These, if separately stated, should appear in the Manufacturing Account, since they represent the cost of maintaining the machinery asset in a fit state to earn revenue.

Carriage, Freight, etc.—Carriage, etc., inwards of raw materials, stores, goods for re-sale and the like should be charged in the Manufacturing or the Trading Account, being part of the prime cost of manufacture, or of acquiring the goods for re-sale; carriage outwards on finished goods despatched, or merchandise re-sold, should appear in the Profit and Loss Account as a distribution expense.

Returns.—Returns both inwards and outwards should be deducted respectively from the Sales and Purchases in the Trading Account in order that the net figures of Sales and Purchases should be shown in each case. Some examination candidates deal with the balance of returns only, a practice which is not in accord with commercial usage, since it does not give a correct figure of the actual turnover for percentage comparisons.

Rent, Rates, and Taxes.—All outstanding liabilities under these heads must be provided for, and any payments in advance must be correctly apportioned. Rates may cover a period beyond the close of the financial year, and in that case they should be apportioned between the two periods, and the prepaid portion be held in suspense as an asset.

Rents received will be credited to the Trading Account, if derived from sub-letting a portion of the factory or warehouse; if office accommodation is sub-let, the rent received will be credited to Profit and Loss Account.

Sometimes rent is received for the use of power supplied to tenants or neighbours. In that case, the rent should be credited to the Trading Account, or be deducted from the cost of power in that account.

Where much property is held and let, the "Terrier" (Plan of Estate and Rent Register) will provide the information for checking rents receivable, in order to ascertain outstandings. All rents accrued due must be taken into account, and provision must be made for irrecoverable arrears.

In examination work, attention must be paid to any indication that charges or outstandings in respect of rent, rates, and taxes, are to be split up between the Trading and Profit and Loss Accounts. If a Trial Balance contains a credit item, "Rents Received," the amount should be credited to the Profit and Loss Account, and not be deducted from rent paid, as candidates sometimes do.

Ground Rent.—Rent paid for the occupation of land upon which houses, offices, or factories are built should be treated as outlined above, and should be apportioned, if possible, between the factory and the office. Ground rent should be stated separately in the Profit and Loss Account. The item should be shown "gross," i.e. any income tax deducted on payment should be debited to Ground Rent Account and credited to Income Tax Account.

Royalties.—Royalties are dealt with in Chapter XVII. In the case of coal and other mines they are a charge against the Working Account

of the colliery or mine. In other cases, they consist of fees paid to patentees, owners of copyright, etc., for the right of user of patent machinery, manufacturing processes (constructional, chemical, etc.), or for the right to reproduce and sell copyrighted works. In all these cases, the royalty should be charged against the Manufacturing or Trading Account. Such royalties are usually payable upon some agreed unit of manufacture or sale, and are fixed by agreement between owner and user. Any royalties accrued due on output or sales, as the case may be, since the last settlement date must be passed through the books, Royalties Account being debited and credited as shown in the case of Wages Account on p. 29. Any income tax deducted on payment should be adjusted as in the case of Ground Rents, as explained above.

Trade Expenses.—This is an omnibus account which includes a multitude of items of diverse kinds. Both the term and the account are often loosely employed, since, usually, it covers both Trading, and Profit and Loss items. In practice, the account is frequently allocated as between Trading or Manufacturing Account, and Profit and Loss Account. If the examination candidate is given no guidance as to the treatment required, he should charge the whole to Profit and Loss Account. Sometimes, however, indication of treatment is afforded in an examination question, thus :—

Illustration.—In the Trial Balance there appears "General Trade Expenses (Factory and Offices), £898," and, later on, the information is given that "the offices occupy one-eighteenth of the floor-space of the company's property." This is an indication that one-eighteenth of the general expenses should be charged to Profit and Loss Account.

The modern tendency is to divide expenses of this kind into "Factory Expenses" and "Office Expenses." If separate items under these headings appear in a Trial Balance, they are doubtless required to be charged to Trading and Profit and Loss Account respectively.

The Inland Revenue officials are apt to be somewhat curious as to the composition of the Trade Charges item in accounts submitted to them; it is advisable, therefore, to describe this debit in the following detail: "Postages, Telegrams, Trade Subscriptions, and Petty Expenses, not including any items not allowable for income-tax purposes." Any items not allowable for income tax, such as charitable subscriptions and donations, etc., should be stated separately.

Stationery, Stamps, etc., in Hand.—Where the expenditure under these, and similar, headings is small, it is usual, in practice, to ignore any stocks on hand. But in some businesses the stock of stationery, catalogues, postage stamps, patent medicine, or entertainment-tax stamps, and similar items may be of considerable value. It is then customary to take stock, and to credit the relative expense account with the valuation, bringing the balance down as stock in hand, and either stating it separately, or adding it to the trading stock as an asset in the Balance Sheet.

Interest on Loans and Debentures.—All accrued interest must be provided for and added to the interest charge in the Profit and Loss Account, and to the Sundry Creditors in the Balance Sheet. Inspection of the "Register of Mortgages and Charges" will furnish the particulars necessary to ensure that all due interest has been provided for. Outstanding interest on bank loans, usually debited quarterly, can be ascertained by scrutiny of the entries in the Pass Book immediately following the close of the financial period. Examination questions frequently indicate that interest has accrued due, and failure to schedule the item amongst the creditors in the Balance Sheet is a fruitful source of error.

Interest received should be credited to Profit and Loss Account. It will probably have resulted from loans or investments, or from charges made in respect of overdue accounts, or for the renewal of bills of exchange, and is, therefore, a *financial* transaction.

In partnership accounts, interest on capital and drawings should be stated separately, and not be combined with trade or investment interest, as some examination candidates are apt to do.

Students sometimes fail to understand that debenture interest is a *debt* due to *creditors*, payable by the company whether the profits made are or are not sufficient to discharge the debt. Debenture interest is in a category essentially different from outstanding "interest" on Preference Shares. Preference dividends are an allocation of profits and their payment is contingent upon sufficient profits being made from which to discharge them.

Trade Interest.—Interest received or paid in connection with the discounting of bills; interest on overdue accounts; interest payable to factors on bonded goods not withdrawn from bond; interest, in the nature of fines, levied in accordance with trade custom, and the like, should be treated in a separate account, and not be included with loan and other fixed annual interest.

Discount.—Trade discount must, of course, be deducted from all sales before they are credited in the Trading Account. The examination candidate is entitled to assume that the purchases and sales appearing in the Trial Balance are stated *net*, i.e. after deduction of *trade* discount.

In some cases, cash discounts received on purchases, or allowed on sales, are deducted from the purchases or the sales items in the Trading Account. Strictly speaking, perhaps this is the more accurate treatment, though the point is debateable, but in the great majority of businesses a single account is opened for cash discounts received or allowed, the balance only being debited or credited as the case may require in the Profit and Loss Account. This course is usually followed when answering examination questions. If, however, both the debit and the credit totals of discount are given in the Trial Balance, it is an indication that the discounts on purchases and sales are to be treated in the Trading Account.

Examination questions sometimes demand the creation of a reserve for discounts. Such reserves are rare in practice. Trade discount, as we have seen, does not reach the Ledger, since it is deducted in the Sales and Purchases Books. Cash discount, it is contended, is contingent upon the debts being paid on or before the expiration of the customary period of credit. In some cases the discount is allowed, in others it is disallowed. In the author's opinion, cash discounts should be treated as financial transactions. If a reserve for discounts is made, the procedure is precisely similar to that employed in the case of reserves for Bad and Doubtful Debts, viz. a debit to Profit and Loss Account of the amount of the reserve, a like amount being deducted from Sundry Debtors in the Balance Sheet. If a reserve is made for discounts on debts due to creditors, the entry in the Profit and Loss Account is reversed, the Sundry Creditors being reduced by the amount of the reserve.

Insurance.—This charge frequently covers a period in advance of the financial year covered by the Accounts. The proportion of the premiums paid applicable to the next financial period should be credited to the Insurance Account and treated as a temporary asset in the Balance Sheet. Such an adjustment is frequently required by examination questions, and failure to deal with *both* aspects of the adjustment is a common occurrence.

Advertising.—When a new commodity is introduced to the public by means of large advertising expenditure, it is the practice, in some cases, to spread a proportion of the initial expenditure over several years, and to treat that portion of the expense not charged to current Profit and Loss Account as a temporary asset to be written off over a period as in the case of Preliminary Expenses. There can be no objection to this procedure, provided that the amount carried forward is determined reasonably. When the cost of advertising has subsided to the normal annual expenditure estimated as necessary to maintain the sale of the commodity in public favour, all advertising expenditure must be charged to Profit and Loss Account for the year in which it is incurred.

Commission.—Commission paid to travellers and salesmen is a selling expense and should be charged to Profit and Loss Account. The destination of commission earned will depend upon the nature of the business. Where, for example, a mantle manufacturer sells goods of his own make, and also goods of a foreign manufacturer on commission, the commission earned should be credited to Trading Account as profit earned by the warehouse. If, however, the commission earned was in respect of financial assistance to the foreign manufacturer, then the income should be credited to Profit and Loss Account.

Managing Directors are sometimes entitled to commission on gross turnover, or on gross or net profits, or on dividends paid to shareholders. The sum due under these heads will need careful computation in accordance with the agreement between the director and the company, and, if it is based upon profits or dividends, should be debited in the

Appropriation Section of the Profit and Loss Account. If the commission is based upon turnover, it should be debited to Trading Account, and care must be taken that all returns are deducted, and that the commission is calculated on *net* sales. Income Tax cannot, in the absence of agreement, be treated as a charge against profits in calculating the amount of a manager's commission based on a percentage of the profits (*Johnston* v. *Chestergate Hat Manufacturing Co.*, [1915]).

Preliminary Expenses.—These consist of the expenses incurred in the registration and flotation of limited companies. They comprise, inter alia, stamp duties and registration fees; the cost of printing, advertising, and distributing the prospectus; printing the Memorandum and Articles of Association; professional fees to solicitors, accountants, valuers, etc.; underwriting commission, and the like. A special ledger account is opened to which such expenses are debited. The company could not have been brought into being without this expenditure, and it is unfair that the first year's trading should bear the whole brunt of this outlay. The usual practice is, therefore, to spread the expenditure over the first three or five years of the company's trading. That such treatment is within the powers of a limited company was recognised in *Bale* v. *Cleland*. The balance of the account must be separately stated as a temporary asset in the Balance Sheet. If the promoter of the company has undertaken to pay all preliminary expenses, care must be taken to ensure that all proper expenses have been charged to the account. Care must also be taken that the total expenses do not exceed the estimate which forms a necessary part of the Statutory Report and Prospectus, though there would appear to be no penalty if the estimate is exceeded.

Dividends Paid.—Preference dividends paid during the current year, or interim dividends paid on ordinary shares, should be entered in the Appropriation Section of the Profit and Loss Account, as explained later, and should not be debited in the main section of that account, as many examination candidates are in the habit of doing. To debit such payments in the main section of the account tends to obscure the account, and to make it difficult to see at a glance the actual trading result for the year.

If the credit balance brought forward from the preceding period is sufficient the dividends may be deducted thus:—

PROFIT AND LOSS ACCOUNT.

(CREDIT SIDE OF APPROPRIATION SECTION.)

			£ s. d.	£	s.	d.
	By Balance from last year		21,462 0 0			
	Less Half-year's dividend on the 6 % Preference Shares	£7,650 0 0				
	Interim dividend of 3 % on the Ordinary Shares	8,000 0 0				
			15,650 0 0			
				5,812	0	0

Or the amount of the dividends paid may be debited to the appropriation section as shown below. Both treatments are adopted in practice and are equally correct.

APPROPRIATION ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Half-year's dividend on the 6 % Preference Shares	7,650	0	0	By Balance from last year . . .	21,462	0	0
,, Interim dividend of 3 % on the Ordinary Shares	8,000	0	0	,, Balance brought down, being net profit for the year . .	33,000	0	0
,, Balance carried down	38,812	0	0				
£	54,462	0	0	£	54,462	0	0
				By Balance brought down	38,812	0	0

Deferred Revenue Expenditure.—Exceptional and costly expenditure is sometimes "held up" in the Balance Sheet, a fixed proportion being charged annually over a period to Profit and Loss Account, as in the case of Preliminary Expenses. The expenditure held in suspense is treated as a temporary asset as explained on p. 36. In some cases special power is given by the Articles to the directors to spread expenditure over a term of years when justified by the nature of the outlay. Apart from this, there does not appear to be any direct legal sanction for the procedure, although it has long been confirmed by custom, and is recognised in the *Companies Act*, 1929, in the case of preliminary expenses, expenses of issue of shares and debentures, commissions on placing shares, etc., which must each be shown separately on the Balance Sheet until written off.

Financial Expenses.—These usually consist of Bank interest and charges; interest on loans and debentures; discount, commission, and similar charges, connected with the financing of private or joint stock enterprises. They are in a somewhat different category from deferred revenue expenditure mentioned above, but they are charges against revenue, and must be dealt with in the Profit and Loss Account.

Income Accrued.—Revenue of this kind, consisting of interest, dividends, rents, and the like, must be treated in the reverse way from the charges against profits enumerated above. Profit and Loss Account must be credited (by means of additions to the relative items), and "Sundry Debtors" be increased by the same amounts. The various ledger accounts will be treated in the manner shown on p. 29, except that the entries will be reversed. Unless the dividends are "fixed" in amount, or have actually been declared, no entries should be made, since the amounts accrued could be estimated only, and may never crystallise. Interest on dividends accruing from Government securities, debentures, and preference shares can be calculated, but dividends on ordinary shares must be declared in order to be known. The required information for entries in respect of income accrued can be ascertained

from the ledger accounts relating to investments, or from the Investment Ledger if one is kept.

Transfer Fees.—Receipts under this heading will, of course, appear only in the Trial Balance of a limited company. The charge for registering the transfer of shares from seller to buyer in the share registers of a limited company is usually at the rate of 2s. 6d. per deed. Income from this source can be checked with the number of transfers filed, and should be credited in the Profit and Loss Account in a separate item, and not be deducted from office expenses, as examination candidates sometimes do.

Apprentices' Premiums.—It has been stated already (see p. 27) that, in the accounts of manufacturing concerns, these premiums should be credited to Manufacturing Account. Examination questions sometimes contain information to the following effect: "Apprenticeship fee (£500) received from A. B. for five years' articles, one year of which has expired." This is an indication that the candidate is required to credit one year's fee (£100) to the current year, and to carry forward the balance of £400 as a liability in the Balance Sheet to be dealt with in equal annual instalments as the years expire.

Profit on Sale of Investments.—If the undertaking be that of a finance or trust company, whose business it is to deal in investments, any profits or losses made are properly dealt with in the Profit and Loss Account. Profits made on the sale of investments held by trading companies may also, without grave objection, be taken to Profit and Loss Account and distributed as dividend. But if the investments held form part of a reserve fund, it is suggested that any profits realised on their sale are more wisely taken to the reserve fund and re-invested.

Premium on Issue of Shares.—When a successful company issues shares at a premium, there is no legal bar against treating such profit as available for dividend. It is the more usual, and conservative course, however, to treat such receipts as capital profits, and to set them out separately on the debit side of the Balance Sheet as "Premiums on Issue of Shares." If they are credited to Profit and Loss Account, the amount should be separately stated, and not merged in the ordinary trading profits.

Entrance Fees and Subscriptions.—If the accounts under construction are those of a club, or non-trading society, it will be found usually that some subscriptions have been paid in advance of the financial period. All amounts so paid in advance must be eliminated from the Income and Expenditure Account, and separately stated in the Balance Sheet as a liability. Subscriptions in arrear must be credited to Subscriptions Account, and be stated separately as an asset in the Balance Sheet. Entrance fees are usually treated as income for the period during which they are received. In strict theory, entrance fees are in the nature of capital, but by common custom they are treated as current revenue, and the examination candidate should

follow this practice, if he is called upon to deal with accounts containing such items.

The student will, at this stage, clearly understand that the one object of all the adjustments referred to above is to ensure that the whole of the income and expenditure which has accrued during the particular financial period dealt with is included in the Trading and Profit and Loss Accounts, no matter whether the expenditure is discharged, or the income is received, or not. The section of the Profit and Loss Account dealt with above should be strictly confined to such items as affect the *actual profit or loss for the period.* All other transactions should be dealt with in the final or Appropriation Section, as explained hereafter (see pp. 61–3).

III. Profit and Loss Accounts (*continued*).

The various items dealt with above originated from actual income and expenditure received, paid, or accrued due. The balances of the ledger accounts whence these items are derived appear in the Trial Balance extracted from a set of books prior to the preparation of the Annual Accounts, or in the list of balances submitted to the examination candidate, as the case may be. But before the net profit for the period can be ascertained, certain adjustments must be made, which in the initial stage are not represented by any entries in the books or the Trial Balance. It is now necessary to consider some of these adjustments.

(*a*) Capital and Revenue.

In the majority of instances expenditure will have occurred during the year which will require to be adjusted as between capital and revenue. Such adjustments require great care if the profit shown is to be the true profit earned. The expenditure with which such adjustments are most frequently concerned is expenditure upon such fixed assets as Buildings, Plant and Machinery, Loose Tools, Patterns, Patents, Fixtures, and Fittings, and the like.

It is impossible to devise an acid test as to what is capital expenditure and what revenue expenditure. The same expenditure may be capital expenditure in some circumstances and revenue expenditure in others. Wages paid by an engineer to workmen for making a boiler to be used in his own works is capital expenditure; the same wages expended upon a boiler manufactured for sale constitute a charge against revenue. In *Accounting*, at p. 57, the present writer remarked as follows: "Broadly speaking, it may be said that expenditure which extends or enhances the earning capacity of the original equipment, and enables it to earn more income, or to work at smaller cost, is capital expenditure. All other expenditure must be charged against the revenue earned by the equipment." In other words, revenue expenditure is that which is incurred in maintaining the fixed assets of a business in efficient

working order; in the conduct and administration of the business; and in the manufacture and distribution of the goods handled.

The first task of the examination candidate when confronted with a list of balances, from which a set of accounts is to be compiled, is to distinguish between the revenue (Profit and Loss) items and the capital (Balance Sheet) items. If the rules given above are applied to these items, and to the adjustments required, there should be no difficulty in discriminating between those appertaining to capital and those appertaining to revenue.

Extract from Examination Question.—Amongst the items in a list of balances the following appear, "Manufacturing Wages, £13,062; Loose Tools, £2, 864." Amongst the instructions appear, "Valuation of Loose Tools at end of the year, £2,100. Manufacturing Wages (£364) were spent in making loose tools for use in the company's factory."

Solution.—In the Manufacturing Account, "Manufacturing Wages" should be stated at £13,062 – £364, i.e. £12,698.

"Depreciation on Loose Tools" in the Profit and Loss Account should be stated at £1,128, arrived at as follows:—

	£
Balance at beginning of the year	2,864
Add Wages paid during the year	364
	3,228
Less Valuation at end of the year	2,100
Depreciation to be charged to Profit and Loss Account ..	£1,128

In the Balance Sheet, the asset would appear as follows:—

	£	
Loose Tools	2,864	
Additions during the year	364	
	3,228	
Less Depreciation	1,128	
		£2,100

As the loose tools in question were added to the manufacturer's plant and not made for sale, the expenditure is capital expenditure. Hence the treatment illustrated above.

Hard-and-fast rules cannot, of course, be laid down. Each case must be considered on its merits, and in the light of the general rules given above.

For example, £500 has been spent upon (*a*) repairs, (*b*) replacements, and (*c*) additions to a cigarette machine. The repairs (*a*), costing £40, were necessary owing to careless handling of the machine. The replacements (*b*), costing £60, were necessary because certain running parts of the machine failed to function properly owing to wear of the parts. The additions (*c*), costing £400, consisted of certain adjustments to the machine, by which its output of cigarettes was increased 3,000 per hour. Neither (*a*) nor (*b*) add anything to the original value of

the machine. These expenditures simply keep the original machine in fair running order. Both expenditures are therefore chargeable to revenue. It is otherwise with the expenditure (*c*). Here there is an addition to the original asset by which its earning power is increased beyond its earning power when it was originally installed. The £400 spent in acquiring this added earning power may therefore be legitimately added to the capital value of the asset.

Revenue Charges in Suspense.—Adjustments may sometimes result in so heavy a charge against revenue that it is customary and legitimate to spread the expenditure over several years. A removal, perhaps, affords a good example of this treatment.

Illustration.—Blanks, Ltd., removed their factory to more commodious premises.

(*a*) The actual cost of dismantling, removing, and re-installing the plant and machinery, furniture, stock, etc., was £2,396.

(*b*) Plant and Machinery stood in the books at £10,876. One machine, standing at £500, was obsolete, and the opportunity was taken to sell it for £100 and replace it by a modern machine costing £875.

(*c*) Furniture stood at £782, and a portion of it, being unsuitable, was sold for £80, the book value of the sold portion being £125. New furniture costing £495 was purchased for the new offices.

(*d*) Fixtures and Fittings stood at £1,200, and were sold to the purchaser of the old premises for £800. New fixtures and fittings were purchased for the new factory at a cost of £1,850.

Solution.—The adjustments as between capital and revenue are as follows :—

	Capital.	*Revenue.*
	£	£
(*a*) Removal Expenses		2,396
(*b*) Plant and Machinery—		
Loss on sale of obsolete machine		400
Cost of new machine	875	
(*c*) Furniture—		
Loss on sale of unsuitable furniture		45
Cost of new furniture	495	
(*d*) Fixtures and Fittings—		
Loss on sale of old fixtures		400
Cost of new fixtures	1,850	
	£3,220	£3,241

It may be assumed that the removal will benefit future years. It is therefore legitimate and usual to spread the revenue adjustment—in this case £3,241—over from three to five years, as in the case of preliminary expenses.

(*b*) Depreciation.

Few, if any, annual accounts are prepared that do not include adjustments for the waste or depreciation that has taken place in the fixed assets employed by the business.

Definition.—Depreciation is the diminution in the utility value of an asset due to natural wear and tear, exhaustion of the subject matter, effluxion of time, accident, obsolescence, or similar causes.

Wear and tear is inseparable from all working assets and can be assessed with approximate accuracy. Depreciation due to obsolescence, fall in market value and other outside causes is difficult to foresee, or provide for. The term "depreciation" suggests waste arising from gradual deterioration rather than sudden loss or diminution in value. *Fluctuation in value* owing to "market" or other causes is not depreciation. Depreciation is a permanent diminution in value; fluctuation is temporary, and may operate to increase temporarily as well as to diminish temporarily the value of an asset. Although, of course, a fall or rise in market value may sometimes prove permanent. The real object of adjustments for depreciation is to distribute the original cost of wasting assets over the term of their working life. Plant and machinery and similar assets employed in earning profits gradually decrease in value through use, and the measure of this shrinkage in value is termed depreciation, and must be provided for out of revenue.

Fluctuation in Value.—The fluctuation in value of *fixed* assets due to outside factors, e.g. a fall in market value of similar assets, may be ignored, since such fluctuations do not reduce the earning power of the assets. Fixed assets are not held for sale, but to earn revenue, and their value to a going concern is not affected by market fluctuations in their value. Fluctuations in the value of *floating* assets, e.g. stock, may also be ignored if they are temporary fluctuations. But if the fall in value appears to be permanent, stock or other floating assets must be written down to the level of current market prices.

Provision for Depreciation Essential.—The author has heard manufacturers say in a year of lean profits that they "cannot afford to allow for depreciation this year." This attitude is quite unsound. The depreciation that should be allowed for bears no relation to the gross profits made for the year. The depreciation has actually occurred. It is a part of the cost of production and must be provided for no matter what gross profits or losses are shown by the Trading Account, otherwise the net profits or losses shown by the Profit and Loss Account and the balance of the manufacturer's capital account will be inaccurate.

Illustration.—Blanks, Ltd., purchased a cigarette machine for £1,200. Its probable life was estimated to be five years, at the end of which time its scrap value would be £100. If no depreciation is written off the machine, it will appear in the books when sold as of a value of £1,100 (i.e. £1,200, the original cost, less £100 the proceeds of sale as scrap). Clearly this wastage of £1,100 should have been spread over the life of the machine. Broadly speaking, Blanks, Ltd., paid £1,100 in advance for the work the machine was going to do in the five years. Each year of the five should therefore have borne its due proportion of the £1,100. Roughly, the waste is £220 per annum, and if this sum had been debited to Profit and Loss Account and credited to Cigarette Machine Account each year, the asset account would have been eliminated at the end of the five years when the machine was sold for £100.

In practice, depreciation is frequently credited direct to the asset account and debited to Profit and Loss Account. It is better, however, to journalise the provisions made, as follows:—

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			£	s.	d.	£	s.	d.
19... Dec. 31	Depreciation Account.. .. .. Dr.		371	0	0			
	To Machinery and Plant (10 %)					200	0	0
	Loose Tools (as per valuation)					151	0	0
	Furniture (5 %)..					20	0	0
	For depreciation for the year ended December 31, 19...							
" 31	Profit and Loss Account .. .. Dr.		371	0	0			
	To Depreciation Account					371	0	0
	Transfer of balance.							

In this manner, a comprehensive record is available for reference in future years. Examination candidates frequently omit one side of the depreciation entries, and the few minutes occupied in journalising them as above will ensure correct treatment, and is time well spent.

Methods of Assessing Depreciation.—The assessment of depreciation must of necessity be based upon *estimate*. There is no room here for dogmatism, and tables of fixed rates of depreciation designed for every trade and asset are worthless. Each case must be judged on its merits and in the light of all the circumstances.

The accountant's task is: (*a*) To assess as closely as possible the money equivalent of the depreciation that will take place during the life of the asset, and (*b*) to distribute this assessment equitably over the working life of the asset.

In order to do this the following *data* are necessary: (*a*) The original cost of the asset, (*b*) the interest on the capital cost, (*c*) the probable working life of the asset as employed (some machines may stand idle for long periods, others may be worked both day and night), (*d*) its scrap value at the close of its useful life, (*e*) the degree to which it is liable to become obsolete, (*f*) whether the asset will be maintained in efficient repair. The answers to (*c*), (*d*), (*e*), and (*f*) will be supplied by the technical experts.

When the amount of the depreciation to be provided for has been assessed, five methods are commonly employed for its distribution over the life of the asset. These are: (1) The straight line, or equal instalment, method; (2) the diminishing balance method; (3) the annuity method; (4) the sinking fund method; (5) the insurance policy method. Occasionally a sixth method—i.e. valuation—is employed. Where a costing system is in operation, or the necessary statistics are otherwise available, other methods, based on output, machine hours, efficiency hours, etc., are sometimes employed.

(1) **The Straight-Line Method.**—By this method, the original cost or present value of the asset is divided by the number of years of its estimated "useful" or "working" life, and an equal part of the cost is debited each year of the life to revenue, repairs and renewals of the asset also being charged to revenue. If the scrap value of the

asset at the close of its life can be estimated, this sum is deducted from the original cost before the annual instalments chargeable to revenue are computed. Thus, if the original cost of a machine be £2,000; its estimated working life be 10 years; and its scrap value at the end be £200, then the amount to be charged to revenue is £2,000 -- £200 = £1,800, or £180 per annum under the straight-line method. If additions are made to the asset during its life, they must be treated in a similar way, and be spread over the remainder of the period in equal instalments.

The advantages claimed for this method are: (*a*) its simplicity, and (*b*) the fact that the asset is completely eliminated at the close of its life. Objections sometimes urged against the method are: (*a*) that additions to an asset so treated cause changes in the asset account, and consequently fresh calculations of the depreciation charge become necessary; (*b*) the question of interest is ignored; and (*c*) the burden of repairs falls more heavily on the later than the earlier years of the life of the asset. As to (*c*), experience proves that in the case of a large plant employing machines of all ages, the system works satisfactorily, since the heavier repairs on the older machines are counterbalanced by the lighter repairs on the newer.

This method is frequently applied to short leases and similar short-lived assets, all repairs being charged to revenue.

Illustration.—A cigarette-boxing machine cost £1,400. The life of the machine is six years. The scrap value is £200. The amount to be spread over the period is, therefore £1,200, or £200 per annum.

CIGARETTE-BOXING MACHINE.

Dr.		£	s.	d.	Cr.		£	s.	d.
To Original Cost		1,400	0	0	By Depreciation Account (annual instalment) ..		200	0	0
					" Balance carried down		1,200	0	0
	£	1,400	0	0		£	1,400	0	0
To Balance brought down		1,200	0	0					

(2) **The Diminishing Balance Method.**—By this method, a fixed percentage, e.g. 10 %, is written off the diminishing balance of the asset account every year. If this method is adopted, care must be taken that the percentage rate employed is sufficiently high to allow of the asset being eliminated at the close of its life.

The chief advantage claimed for this method is that the revenue charge is equitably averaged, inasmuch as, in the early years, when the machine is new, the depreciation charge is heavy and the repair and maintenance charge light, whereas, in the later years, when the repair and maintenance charge is heavy, the depreciation charge is light.

Experience shows that this is probably the most popular method with business men. The difficulty is to induce them to adopt a per-

centage high enough to reduce the asset to its scrap value at the close of its working life.

Examination candidates appear to experience difficulty when a Trial Balance contains an asset account (commencing balance) with additions during the year, and also instructions that depreciation is to be provided at a given rate. In the absence of instructions to the contrary, the candidate should provide for depreciation at the given rate on the total *final* debit of the asset account.

Illustration.—Machinery and Plant, £12,950; Additions during the year, £479. The company's workmen were paid £121 wages in installing the additions to the Machinery and Plant. Depreciation at 10 % is to be written off Machinery and Plant. (Extracted from an Examination Trial Balance.)

Solution.

MACHINERY AND PLANT ACCOUNT.

Dr.		£	s.	d.			£	s.	d. Cr.
	To Balance	12,950	0	0					
	,, Additions during the year	479	0	0					
	,, Transfer from Wages Account	121	0	0					
	£	13,550	0	0					

Ten per cent. depreciation on £13,550, i.e. £1,355, should be debited to Profit and Loss Account, and the asset be shown in the Balance Sheet as follows :—

	£	£
Machinery and Plant	12,950	
Additions during the year	600	
	13,550	
Less Depreciation	1,355	
		£12,195

In actual practice, additions may be made so late in the financial period covered by the accounts that provision for depreciation may be considered unnecessary. In any case, additions create no difficulty, since depreciation of them can be adjusted to the date when they were made, and the needs of the case. In the great majority of cases, depreciation is written off the *final* balance of the asset account as shown in the above illustration.

In examination questions, where additions to an asset are included in the Trial Balance, and a general rate is named for the depreciation, the candidate is sometimes informed in the " Instructions " following the Trial Balance that the average date of the additions was, e.g., September 30th. This indicates that the rate of depreciation named is to be based upon this average date. Where the financial period dealt with by the accounts covers a year ending at December 31st, this means that the additions are to be depreciated at the rate named, but for three months instead of the whole of the year.

The student will realise that whereas a fixed depreciation percentage charged each year upon the *original cost*, as in the straight-line method, will eliminate the asset during its life, the same percentage as employed by the diminishing balance method will leave a considerable balance on the books at the end of the life of the asset. For example, a machine costing £1,000 and possessing no scrap value, having an estimated life of five years, would, on a 20 % basis of depreciation, be eliminated as an asset at the end of the five years, but, if it were depreciated at the rate of 20 % on the diminishing balance, the asset would stand in the books as of a value of £327 13s. 7d. at the close of the period. As *The Accountant* has pointed out, an asset depreciated at the rate of 10 % on the diminishing annual balance will have a book value of over 35 % of its original cost at the end of ten years, 12 % after 20 years, 4 % after 30 years, and 1 % after 43 years. It is not always easy to convince business men of this difference between the two methods.

(3) **The Annuity Method.**—It is assumed by this method that the capital sunk in the purchase of the asset is earning interest. The annual depreciation charge is ascertained from Tables, and is calculated so as to eliminate the asset, *together with interest on the capital sunk*, at the close of the life of the asset. Interest on the capital sunk, at the agreed rate, is debited to the asset account and credited to revenue each year. This theory assumes that the capital expended on the asset earns the interest credited to revenue in each financial period. The interest taken credit for decreases automatically as the depreciation charge reduces the book value of the asset. The depreciation charge is constant. It is clear, therefore, that revenue bears a gradually increasing burden. This is probably the most scientific system, but it is not popular with the commercial community. An objection to the method is that when additions are made to the asset account revised calculations must be made, and, particularly also, that, in the early years, the book value of the asset is in excess of its real value. By this method, the asset account will appear as follows :—

ASSET ACCOUNT

Dr. Cr.

		£	s.	d.			£	s.	d.
	To Original Cost	1,200	0	0	By Profit and Loss Account, being annual depreciation charge (as per actuarial tables) for 5 years		277	3	4
	„ Transfer to Profit and Loss Account, being interest at 5 % ..	60	0	0	„ Balance, carried down		982	16	8
£		1,260	0	0		£	1,260	0	0
	To Balance brought down	982	16	8					

If preferred, the transfer of interest may be made to the credit of Interest Account, and thence, in due course, to the Profit and Loss Account.

When the Government purchased the property of the National Telephone Company, the Company claimed depreciation on the annuity basis, whilst the Government sought to base their valuation on the straight-line method, and succeeded in sustaining their claim to employ the latter method.

(4) **The Sinking Fund Method.**—This method also takes into account the question of interest. A fixed amount is charged each year to revenue, and at the same time an equivalent amount of cash is separately invested. The annual instalment represents the amount which, invested at compound interest, will, at the close of the period, realise a sum equal to the original cost of the asset. The asset remains in the books at its original cost until the close of its life, when the sinking fund is used to eliminate it. The advantage of this method is that it provides the actual cash wherewith to replace the asset.

The records of a sinking fund invested in Stock Exchange securities (Arcadia 5 % Gold Bonds at par) are as follows :—

Dr. SINKING FUND. Cr.

Year.			£	s.	d.	Year.			£	s.	d.
1	To Balance carried down		1,000	0	0	1	By Profit and Loss Account		1,000	0	0
2	To Balance carried down		2,050	0	0	2	By Balance brought down		1,000	0	0
							,, Profit and Loss Account		1,000	0	0
							,, Interest		50	0	0
		£	2,050	0	0			£	2,050	0	0
3	To Balance carried down		3,152	10	0	3	By Balance brought down		2,050	0	0
							,, Profit and Loss Account		1,000	0	0
							,, Interest		102	10	0
		£	3,152	10	0			£	3,152	10	0
						4	By Balance brought down		3,152	10	0

INVESTMENT OF SINKING FUND.

Dr. (ARCADIA 5 % GOLD BONDS.) Cr.

Year.			£	s.	d.				£	s.	d.
1	To Cash		1,000	0	0						
2	,, Cash		1,050	0	0						
3	,, Cash		1,102	10	0						
		£	3,152	10	0						

Note.—In practice, the investment of the cash instalment and the re-investment of the interest may not take place until after the end of each year, so that on the Balance Sheet the amount of the Sinking Fund may appear greater than the amount of the Investment. The cash instalment for the last year and the interest would not be re-invested, but, with the proceeds of the sale of the investment, would form the fund available for the purchase of the new asset.

(5) **The Insurance Policy Method.**—This is another form of sinking fund. A capital endowment policy is taken out with an Assurance Company for the amount necessary to replace the asset, maturing at the close of the life of the asset. The advantage of this method is, as compared with the Sinking Fund method, that the *exact* sum required will be forthcoming when the asset is to be replaced, whereas a sinking fund invested in Stock Exchange securities may, owing to market fluctuations in the stock selected for investment, result in a deficiency at the required date. Again, a sinking fund, by pressure of circumstances, may be diverted from its original purpose.

In some cases an Endowment Policy Account is opened and debited with the premiums as paid, and treated in the Balance Sheet as an investment accumulating at interest. Profit and Loss Account is debited, and the Asset Redemption Account is credited with the amount of the annual premiums.

ENDOWMENT POLICY ACCOUNT.

Annual Premium : £100, payable January 1st. Sum assured : £1,320.
Term : 10 years.

Dr. Cr.

Year.		£	s.	d.			£	s.	d.
1 (Jan. 1)	To Cash (Premium) ..	100	0	0					
1 (Dec. 31)	,, Interest at 5 % ..	5	0	0					
		105	0	0					
2	To Cash	100	0	0					
2	,, Interest at 5 % ..	10	5	0					
		215	5	0					
3	To Cash	100	0	0					
3	,, Interest at 5 % ..	15	15	3					
		£331	0	3					

ASSET REDEMPTION ACCOUNT.

Dr. Cr.

		£	s.	d.	Year.		£	s.	d.
					1 (Dec. 31)	By Profit and Loss Account	100	0	0
						,, Policy Account (Interest)	5	0	0
							105	0	0
					2	By Profit and Loss Account	100	0	0
						,, Policy Account (Interest)	10	5	0
							215	5	0
					3	By Profit and Loss Account	100	0	0
						,, Policy Account (Interest)	15	15	3
							£331	0	3

In other cases, the surrender value of the policy only, as ascertained from the company, is taken into account, in which case no interest entries are made, and adjustments are necessary from time to time to maintain the surrender value basis. At the close of the period, the policy account, under this method, will show a profit which will be transferred to the Asset Redemption Account.

Assuming a nominal surrender value of £10 and £25 for the first and second years respectively, and thereafter an amount equal to all the premiums paid plus 2 % compound interest, the entries required to maintain the Policy Account at surrender value are given on p. 50.

(6) **Valuation Method.**—Sometimes, depreciation is determined by the process of actual re-valuation of the asset at the close of each financial period. In any case, such valuations, where practicable, are valuable as a periodical check upon book values arrived at by ordinary depreciation methods. This method is not suitable for heavy fixed assets such as buildings and the like. Indeed, in unscrupulous hands, the method might become dangerous, in addition to being costly. But some assets are particularly suitable for re-valuation, e.g. loose tools, copyrights, patents, horses, cattle, sacks, cases, casks, bottles, etc. The difference between the book value of assets and the valuation is treated as depreciation and written off accordingly. Should the valuation disclose an appreciation in value, it is wise for book-keeping purposes to ignore the appreciation.

In some businesses, it is usual to treat loose tools and similar assets as stock, and include them in the stock valuation. Any increase or decrease in value then passes through the Manufacturing or Trading Account, and no separate asset item appears in the Balance Sheet.

Examination questions frequently indicate that the depreciation on certain assets is to be based on a valuation, particulars of which are given, as already explained at pp. 27–28.

Provision for Waste—Legal and Commercial Views.—The necessity for providing for all waste and depreciation preliminary to the ascertainment and distribution of net profits is unlikely to be questioned by the sound business man. But it cannot be said that this necessity is in all cases a matter of legal obligation. A series of legal decisions, of abiding interest to accountants, beginning with *Lee* v. *Neuchatel Asphalte Co., Ltd.*, (1889), is dealt with at some length in the author's *Accounting*, pp. 320–327, and to those pages the student is referred, since to reproduce them here would be to occupy space that can ill be spared in this treatise. Study of these decisions will convince the student that, though from the legal point of view it is not always incumbent upon directors to provide for depreciation in wasting assets prior to the distribution of profits, he will be unwise to go further, as he sometimes does, and generalise that, legally, provision for waste is unnecessary. It is suggested that the most that can be inferred from the judgments in question is that, in any particular case, the Court will

decide whether provision for waste is or is not necessary after taking into full consideration the particular circumstances of the case. Depreciation in *floating* assets must be made good. But, in certain circumstances,

ENDOWMENT POLICY ACCOUNT.

Dr. Year.		£	s.	d.	Year.	Cr.	£	s.	d.
1 (Jan. 1)	To Cash (Premium) ..	100	0	0	1 (Dec. 31)	By Balance carried down, being surrender value at date..	10	0	0
					1	" Asset Redemption Account	90	0	0
		£100	0	0			£100	0	0
2	To Balance brought down	10	0	0	2	By Balance carried down, being surrender value at date..	25	0	0
2	" Cash (Premium)..	100	0	0	2	" Asset Redemption Account	85	0	0
		£110	0	0			£110	0	0
3	To Balance brought down	25	0	0	3	By Balance carried down, being surrender value at date..	309	0	0
3	" Cash (Premium)..	100	0	0					
3	" Asset Redemption Account	184	0	0					
		£309	0	0			£309	0	0
4	To Balance brought down	309	0	0					

ASSET REDEMPTION ACCOUNT.

Dr. Year.		£	s.	d.	Year.	Cr.	£	s.	d.
1 (Dec. 31)	To Policy Account ..	90	0	0	1 (Dec. 31)	By Profit and Loss Account	100	0	0
1	" Balance carried down	10	0	0					
		£100	0	0			£100	0	0
2	To Policy Account ..	85	0	0	2	By Balance brought down	10	0	0
2	" Balance carried down	25	0	0	2	" Profit and Loss Account	100	0	0
		£110	0	0			£110	0	0
3	To Balance carried down	309	0	0	3	By Balance brought down	25	0	0
					3	" Profit and Loss Account	100	0	0
					3	" Policy Account ..	184	0	0
		£309	0	0			£309	0	0
					4	By Balance brought down	309	0	0

the Court has refused to compel directors to make good waste in *fixed* assets prior to the distribution of dividends, and has also refused to compel directors to pay dividends where they deemed it desirable to retain the balance standing to the credit of Profit and Loss Account for the purpose of making good waste in fixed assets.

It would appear from the cases referred to above that the Court is primarily concerned with the protection of creditors. A limited company is, however, also concerned with the rights of its shareholders and the preservation of its capital. Hence the wise practice followed by directors, and by the business community generally, of creating reserves for all known wastage and contingencies.

(*c*) Sinking Funds.

The provisions for waste dealt with hitherto are *charges against profits or costs of production*. Certain other provisions sometimes become necessary, which are *appropriations out of profits* rather than charges against profits, such, for instance, as provisions made to meet accruing liabilities. These are made by means of *Sinking Funds*.

Definition.—The term "Sinking Fund" was first used to denote moneys set aside by the Treasury for the reduction and ultimate extinction of the National Debt—*to sink the National Debt.* It has now been widely adopted by the commercial world. A sinking fund may be defined as a fund created by means of periodical instalments invested in securities, and accumulated at compound interest. The object of such funds is to provide a definite capital sum at a definite date wherewith either (*a*) to redeem a liability, or (*b*) to replace an asset. The chief advantage of these funds is that they avoid the heavy strain on the working capital of an undertaking which would result if a large sum of money had suddenly to be withdrawn from the business. Students sometimes confuse sinking funds with reserves. Reserves may be created for general purposes only; sinking funds are created to serve a *specific purpose.*

Creation of Sinking Fund.—Sinking funds are built up by equal yearly or other periodical instalments, which, placed on fixed deposit with a bank, or invested in sound securities, will, with the interest earned, similarly placed on deposit or invested in the securities selected, provide the definite capital sum on the definite date required. The instalments are not a charge against profits, but they cannot be paid except out of profits. It is clear that when the cash instalments are withdrawn from the business and placed on deposit or invested, the transactions are merely a change from one type of asset to another. But the change of assets deprives the company of the power to distribute as dividends that portion of the profits so withdrawn. That being so, it is the usual practice to debit the Appropriation Section of the Profit and Loss Account with the instalments so withdrawn, and to credit the withdrawals to a Sinking Fund Account. The balance of the

Sinking Fund Account at any time represents the total profits set aside. If this practice is not followed, the result will be that a gradually increasing balance will be carried forward on the Profit and Loss Account from year to year, although the balance is not available for distribution in cash.

Instalment Calculation.—The amount of the periodical instalment to be set aside is based upon the following considerations: (*a*) The amount of the capital sum to be provided; (*b*) the date when the fund will be required; (*c*) the rate of compound interest expected to be realised on the instalments invested. On these data, any standard book of tables will show the amount of the annual instalment required.

Illustration.—Z, Ltd., issued £55,000 15-year notes. What is the amount of the annual instalment to provide a Sinking Fund for their redemption, assuming that the Sinking Fund investments will earn 4 % per annum?

From interest tables it is found that the amount of an annuity of £1 per annum payable at the *end* of each year for 15 years at 4 % is £20·0235876. Thus the amount required to accumulate £55,000 is:—

£55,000 ÷ 20·0235876 = £2,746 15s.

Uses of Sinking Funds.—It has already been shown that by various methods the wastage of an asset is provided for by depreciation charged in the Profit and Loss Account. Such processes are designed to eliminate the asset from the books at the close of its life, but they do not provide the money wherewith to replace the asset. Hence the advantage of a sinking fund that actually when the need arises provides the capital sum by which such assets as Plant and Machinery, Leases, Buildings, Mining Rights, and the like can be replaced. A sinking fund is equally useful to provide funds to meet at maturity such liabilities as Debentures, Loans, Bonds, Dilapidations under a Lease, the loss on Terminable Securities purchased at a premium, etc.

SINKING FUND ACCOUNT.

For the Redemption of £12,000 7 % Bonds repayable January 1, 1936.

Dr. Cr.

Date	Particulars		£	s.	d.	Date	Particulars		£	s.	d.
1936. Jan. 1	To General Reserve Account		12,000	0	0	1932. Dec. 31	By Profit and Loss Appropriation Account		2,784	2	10
						1933. Dec. 31	,, Cash, Interest ..		139	4	2
						,, 31	,, Profit and Loss Appropriation Account		2,784	2	10
						1934. Dec. 31	,, Cash, Interest ..		285	7	6
						,, 31	,, Profit and Loss Appropriation Account		2,784	2	10
						1935. Dec. 31	,, Cash, Interest ..		438	17	0
						,, 31	,, Profit and Loss Appropriation Account		2,784	2	10
		£	12,000	0	0			£	12,000	0	0

SINKING FUND INVESTMENT ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
1932. Dec. 31	To Cash, Instalment	2,784	2	10	1933. Dec. 31	By Balance carried down	5,707	9	10
1933. Dec. 31	" Cash, One year's interest re-invested	139	4	2					
" 31	" Cash, Instalment	2,784	2	10					
		£5,707	9	10			£5,707	9	10
1934. Jan. 1	To Balance brought down	5,707	9	10	1934. Dec. 31	By Balance carried down	8,777	0	2
Dec. 31	" Cash, Interest re-invested	285	7	6					
" 31	" Cash, Instalment	2,784	2	10					
		£8,777	0	2			£8,777	0	2
1935. Jan. 1	To Balance brought down	8,777	0	2	1935. Dec. 31	By Cash, Proceeds of sale of investments	12,000	0	0
Dec. 31	" Cash, Interest *..	438	17	0					
" 31	" Cash, Instalment *	2,784	2	10					
	£	12,000	0	0		£	12,000	0	0

* In practice these two amounts would not be invested.

7 % BONDS ACCOUNT.

Repayable at Par, January 1, 1936.

Dr.		£	s.	d.		Cr.	£	s.	d.
1936. Jan. 1	To Cash, Repayment	12,000	0	0	1932. Jan. 1	By Cash on Issue ..	12,000	0	0

GENERAL RESERVE ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
					1936. Jan. 1	By Sinking Fund Account	12,000	0	0

The above illustration shows the working of a sinking fund created to redeem a liability. The contributions to the fund are assumed to have been invested in gilt-edged securities producing 5 %.

Sinking Funds Contrasted.—It may be well again to remind the student of the difference between a sinking fund created to redeem a liability, and one created to replace an asset.

(*a*) *Redemption of Liability.*—In this case, the instalments are not a charge against profits but *appropriations* of profits. But since cash has been taken out of the business, it is necessary to reserve an equivalent amount of profit. If the profits were divided " up to the hilt " without appropriating the Sinking Fund instalment each year, the business would be drained of working capital.

When a sinking fund operation matures, and the investments

have been realised, and the liability paid off, it is clear that the liability account and the investment account cancel each other and disappear from the Balance Sheet. There remains the Sinking Fund Account, built up by the annual appropriations from Profit and Loss Account. That account now constitutes a general reserve, created out of undivided profits, and should be transferred to General Reserve Account.

(*b*) *Replacement of an Asset.*—Here, the instalments represent the wastage of an asset, and are charges against revenue, since they take the place of depreciation. The book value of the asset remains undisturbed until, at the close of its life, the asset account is eliminated by the transfer thereto of the Sinking Fund Account. The new asset to replace the old is purchased with the funds made available by the realisation of the sinking fund investments, and a new asset account is opened in the ledger.

Redeemable Preference Shares.—Where such shares have been issued, and it is intended to redeem them out of profits, it is a wise precaution to appropriate profits year by year over the period from the date of issue to the date of redemption in order to build up a Fund

LEASE ACCOUNT.

Purchased January 1, 1932. Term: 5 Years. Renewable on Same Terms at end of Period.

DR.			£	s.	d.			CR.	£	s.	d.
1932. Jan. 1	To Cash		1,000	0	0	1936. Dec. 31	By Sinking Fund Account		1,000	0	0
1937. Jan. 1	To Cash		1,000	0	0						

SINKING FUND ACCOUNT.

INVESTED IN GILT-EDGED SECURITIES PRODUCING 5 % PER ANNUM.

DR.			£	s.	d.			CR.	£	s.	d.
1936. Dec. 31	To Lease Account ..		1,000	0	0	1932. Dec. 31	By Profit and Loss Account		180	19	6
						1933. Dec. 31	" Cash, Interest ..		9	1	0
						" 31	" Profit and Loss Account		180	19	6
						1934. Dec. 31	" Cash, Interest ..		18	11	0
						" 31	" Profit and Loss Account		180	19	6
						1935. Dec. 31	" Cash, Interest ..		28	10	6
						" 31	" Profit and Loss Account		180	19	6
						1936. Dec. 31	" Cash, Interest ..		39	0	0
						" 31	" Profit and Loss Account		180	19	6
		£	1,000	0	0			£	1,000	0	0

SINKING FUND INVESTMENT ACCOUNT.

Dr.			£	s.	d.		Cr.		£	s.	d.
1932. Dec. 31	To Cash, Instalment..		180	19	6	1936. Dec. 31	By Cash		1,000	0	0
1933. Dec. 31	,, Cash, Interest re-invested .. .		9	1	0						
,, 31	,, Cash, Instalment .		180	19	6						
			371	0	0						
1934. Dec. 31	,, Cash, Interest ..		18	11	0						
,, 31	,, Cash, Instalment..		180	19	6						
			570	10	6						
1935. Dec. 31	,, Cash, Interest ..		28	10	6						
,, 31	,, Cash, Instalment..		180	19	6						
			780	0	6						
1936. Dec. 31	,, Cash, Interest ..		39	0	0						
,, 31	,, Cash, Instalment..		180	19	6						
		£	1,000	0	0			£	1,000	0	0

represented by readily realisable securities, otherwise the requisite cash may not be forthcoming on the redemption date without seriously depleting the working capital.

Deficiency or Surplus on Realisation.—If the sinking fund has been invested in Stock Exchange securities, it is almost certain that the actual sum required will not be realised by their sale. There will be either a surplus or a deficiency on realisation. Any surplus should be carried to general reserve; any deficiency must be treated as a loss, the loss being debited to Profit and Loss Account, and credited to Sinking Fund Investment Account.

(*d*) Reserves.

The term "Reserve" is of wide import. It may be defined, broadly, as a provision made to meet known or anticipated waste, liability, loss, or contingency, or as a prudent retention of profits in the business in order to strengthen it financially. Reserves may be made (*a*) for specific purposes, obligatory or voluntary; (*b*) to meet contingencies; (*c*) for general purposes.

(*a*) *Reserves for Specific Purposes.*—These may include reserves for outstanding liabilities such as salaries, wages, commission, directors' fees, rent, interest accrued, income tax, and similar outstanding expenses.

(*b*) *Reserves to meet Contingencies.*—These may include claims pending for damages, or for workmen's compensation, apportionment of premium income carried forward, fees paid in advance, provision for bad debts, discounts, and the like.

Reserves made for purposes enumerated under (*a*) and (*b*) above are obligatory, and are charges against profits, but

(c) *Reserves for General Purposes* presuppose available profits out of which to make them, and are voluntarily made for the purpose of stabilising the financial position of an undertaking, e.g. a General Reserve Fund, Dividend Equalisation Fund, Pensions Fund, and the like. Such reserves as these appear on the liabilities side of the Balance Sheet.

Treatment in Accounts.—If the reserves are made in connection with assets, their amount is deducted from the relative asset in the Balance Sheet, e.g. Leaseholds, Exhaustion of Minerals, Machinery and Plant, and the like.

If the reserves are made for general purposes, they are set out separately under appropriate headings on the liabilities side of the Balance Sheet, e.g. Dividend Equalisation Fund, Employees' Pension Fund, General Reserve Fund, etc. This difference in treatment should be noted by the student.

If the reserves relate to outstanding expenses such as wages, salaries, and the like, the amount of the reserve is debited to the relative ledger account and brought down as a credit balance as shown on p. 29, and appears as a separate item after the caption "Sundry Creditors" in the Balance Sheet.

Simple as it is, the correct treatment of such reserves appears to present difficulty to many examination candidates and marks are lost accordingly.

Illustration.—The following is extracted from an examination exercise :—

"When preparing the accounts [i.e. Manufacturing Account, Profit and Loss Account, and Balance Sheet] the subjoined information must be considered :—

(a) Three days' wages, £346 ; Office Salaries, £96 ; and Directors' Fees, £500, had accrued due as on December 31, 19...

(b) Insurance (Factory), £82, had been paid in advance."

The following items appeared in the Trial Balance :—

"Manufacturing Wages, £13,862 ; Office Salaries, £1,345 ; Directors' Fees, £500 ; Insurance (Factory, £397 ; Office, £92), £489."

Solution.—When preparing the accounts the candidate should :—

(1) *Add* £346 to the Manufacturing Wages, £13,862, making the total debit to Manufacturing Account £14,208.

(2) *Add* £96 to Office Salaries, £1,345, making the total debit to Profit and Loss Account £1,441.

(3) *Add* £500 to Directors' Fees, £500, making the total debit to Profit and Loss Account £1,000.

(4) *Deduct* £82 from Factory Insurance, £397, reducing the total debit to Manufacturing Account to £315.

(5) On the *liabilities side* of the Balance Sheet, under the item "Sundry Creditors," he should *add* "Ditto, Outstanding Expenses, £942." The details composing this amount may be set out, if desired, but, in practice, the total only would be given. On the *assets side* of the Balance Sheet there should appear an item "Unexpired Insurance, £82," or some similar heading covering any expenses paid in advance.

Contingencies.—Contingent liabilities may exist which do not call for financial record in the books, but to the existence of which attention should be called by means of a note or notes on the face of the Balance Sheet. Such contingent liabilities are, e.g., arrears of cumulative preference dividends, liability on partly paid shares, or bills under discount, etc. These are not actual liabilities until they crystallise as such, and can only be noted for the information of shareholders.

Legal Position.—Limited companies, unless expressly directed by their Articles so to do, are under no obligation to create reserves. The Articles of most companies, however, follow the example set by Table A (Art. 93) and give the directors power to make such reserves as they deem advisable prior to the distribution of profits.

In a private firm, the question of reserves is, of course, decided at the discretion of the partners.

Local authorities carrying on trading undertakings are under obligation to provide reserve funds, the amount of which is frequently prescribed and restricted by the Statute, Order, or Licence under which they work. In some cases, it is obligatory to invest reserves in outside securities, e.g. under the Provisional Orders for the electricity undertakings of local authorities. No such obligations exist in connection with non-trading sections of local administration.

Reserve Fund or Account.—Examination candidates are apt to lay down a hard-and-fast rule that reserves must of necessity be invested outside the business, and further, that the term " Fund " is employed only when the reserve is separately invested, the term " Account " being used to signify that the reserve is retained in the business, and not separately invested. The volume of academic discussion that has taken place in this connection is not very enlightening from the student's point of view. It might be convenient if the commercial community agreed to use such nomenclature, but no such agreement exists. Reference to published accounts will show that the two terms are used indiscriminately.

It is clear that a sinking fund raised for a specific purpose *must*, if it is to fulfil its proper function, be invested in outside securities. In commercial companies, where profits are withheld from distribution and carried to reserve to enlarge the working capital and fortify the financial stability of the company, the question whether the amounts so withheld should be separately invested is one of financial policy to be determined in the light of all the circumstances. The possession of outside investments obviously strengthens the position of a company, if *it can afford them*. It cannot, however, indulge in luxuries of this kind if their purchase would seriously deplete the company's working capital, or if, by retaining the money in the business, it can be employed to far greater profit. In the case of banks, trust and financial companies, and in businesses where profits are liable to violent fluctuations, the

outside investment of reserves in readily convertible securities may be conceded as being commendable and prudent.

Repairs and Renewals Fund.—Reserves created for these purposes are sometimes useful, particularly in trades subject to heavy repairs at irregular intervals. In such cases, the Profit and Loss Account is charged with equal annual instalments, and the actual repairs, as and when effected, are debited against the reserve, the charge being thus equalised as between one trading period and another. The amount of the annual charge to Profit and Loss must be based on the experience of a series of past years, and this experience must be reviewed and corrected from time to time, care being taken that the reserve account, in normal circumstances, remains in credit.

Reserves for Bad Debts.—Almost every examination Trial Balance includes a credit item of this kind, e.g. "Reserve for Bad Debts, 31st Dec. 19.., £250." An extraordinary number of candidates come to grief when dealing with such an item, yet the treatment is so simple that it should not be necessary to refer to it in an advanced treatise.

The usual commercial practice is to reserve a fixed amount on the Sundry Debtors at the close of the balancing period. The Journal entry, if one is made, is as follows :—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Profit and Loss Account .. .. Dr.	P.L.	250	0	0			
	To Reserve for Bad and Doubtful Debts	P.L.				250	0	0
	Being 5 % Provision upon the amount of the Sundry Debtors on this date (£5,000).							

In practice, the entry would probably take the form of a direct transfer from Profit and Loss Account to Reserve for Bad Debts Account. It will be clear, therefore, that when the books are closed a credit balance of £250 remains on the Reserve Account. This, let us assume, is the item that appears in the examination Trial Balance referred to above. It represents the reserve made twelve months ago. Let us assume, further, in the Trial Balance, an item "Sundry Debtors, £7,000," and that the instructions state that "a reserve for bad debts is to be made equal to 5 % on the Sundry Debtors." For this purpose, therefore, £350 is required, but, as a Reserve of £250 already exists, the further charge against current profits will be no more than £100. The statement in the Profit and Loss Account will be as follows :—

	£ s. d.	£ s. d.
Reserve for Bad Debts :—		
December 31, 19..	350 0 0	
Less *December* 31, 19..	250 0 0	
		100 0 0

and in the balance sheet as follows :—

	£	s.	d.	£	s.	d.
Sundry Debtors	7,000	0	0			
Less *Reserve*	350	0	0			
				6,650	0	0

The Trial Balance may also include an item "Bad Debts," indicating that bad debts to the amount stated have actually occurred, and been written off during the year. It would not be incorrect to debit the amount of these debts against the reserve of £250, and increase the new reserve charge correspondingly. But it is the wiser course, and the usual commercial practice, to state the reserve as set out above, and to debit the actual bad debts in a separate item to Profit and Loss Account.

If the amount owing by Sundry Debtors is less than in the preceding year, and the same rate of provision is made, an entry similar to that given above must be made on the *credit* side of the Profit and Loss Account, writing back that proportion of the reserve that is no longer required.

A strange but common error made by examination candidates is to charge Profit and Loss Account with provision for bad debts at the rate given, but to ignore the already existing reserve. The candidate either fails to "balance," or he deducts both the old and the new reserves from the Sundry Debtors.

It is the practice in some cases to take out a policy of insurance against losses arising from bad debts with "Lloyd's," or one of the Insurance Companies undertaking this class of risk. In such event the amount of the annual premium should be charged to Profit and Loss Account, no further provision being necessary.

Reserve Account for Depreciation.—Under the double-account system, the only method of providing for depreciation is to create a reserve which appears on the liabilities side of the Balance Sheet, the asset being left at its original cost on the assets side. The practice is not commended as applicable to accounts kept under the single-account system, and should not be followed by examination candidates. Depreciation in accounts kept on the single-account method should be deducted from the relative asset in the Balance Sheet, in order to show clearly its net book value at the date of the accounts.

Reserve for Discounts.—It has already been stated that it is unusual to reserve for discount on book debts, except in trades which allow exceptionally large discounts. Usually, discount (which may or may not be claimed) is treated as a financial transaction within the period when it is actually allowed. But occasionally the examination candidate is instructed to reserve for discounts on the basis of a stated percentage on the book debts. In that case the procedure to be followed is identical with that already described in connection with bad debt reserves. In the still rarer event of an instruction being given to reserve for discount that may be secured from Sundry Creditors, the discount claimable

must be credited to Discount Account and debited to Discount Receivable Account, the balance of Discount Account being written off to Profit and Loss Account.

Dividend Equalisation Reserve (Fund).—Companies whose profits are liable from any cause to fluctuations sometimes create a reserve for the purpose of maintaining a level rate of dividend, drafts being made on the reserve in years of lean profits for this purpose. Such reserves are created in the usual way by appropriations from the profits of good years.

Capital Reserve.—This is a term applied to those profits which are carried to reserve, because it is not prudent to appropriate them as ordinary revenue. Such profits may result from the sale of fixed assets at a higher price than they stand at in the books; from premiums derived from an issue of shares or debentures; from the re-valuation of assets; from profits accrued prior to incorporation, and the like. Such reserves should be separately stated in the Balance Sheet.

It should be noted that the Capital Redemption Reserve Fund created when Redeemable Preference Shares are redeemed out of profits is an entirely distinct "capital reserve" which cannot be disturbed except as provided in S. 46 (see p. 301).

Reserve Liability.—This term is applied by limited companies to that portion of their subscribed capital that can only be called up in the event of liquidation. Under S. 49 of the *Companies Act*, 1929, a company may, by special resolution, take power to determine that a specified portion of each share shall remain uncalled, except in the event of liquidation. Banking companies, for example, frequently maintain considerable reserve liability on their shares for the protection of their customers.

Secret Reserves.—It is the practice of banks, financial houses, and sometimes of commercial firms, to accumulate reserves out of profits, and not to disclose them in the accounts. There are various ways of creating such reserves: assets may be maintained at cost notwithstanding that they have appreciated heavily; capital expenditure may be charged to revenue; assets may be altogether written off and eliminated from the Balance Sheet; liabilities may be overstated by means of excessive reserves; over-provision may be made for contingencies, such as bad debts, etc., and the reserve be included with the Sundry Creditors; stock may be undervalued, and the like.

The ethics of secret reserves have been debated for years, but the arguments of the disputants cannot be followed here. The author may, however, be permitted to say that he sees no reason to revise the remarks made in *Accounting*, at p. 97, viz. that:—

(*a*) The creation of secret reserves, within reasonable limits, is widely approved by financial authorities.

(*b*) Many items in a Balance Sheet must of necessity be based upon estimate only. To the extent, therefore, that the temperament

of the person who constructs it is prudently biassed to that extent will secret reserves always exist. The reserves may be small or large, but they will be there.

(*c*) In the author's opinion, this is not a question that admits of hard-and-fast decision.

Each case must be judged on its merits, remembering that the duty of directors is, primarily, to the company as a company and not to the shareholders of to-day or to-morrow as individuals.

The interests of the company as a continuing business are paramount, the interest of the temporary or speculative shareholder being strictly subordinate thereto. In any case, auditors have power, fortified by the decision in *Newton* v. *The Birmingham Small Arms Co., Ltd.*, [1906], to report to the shareholders if, in their opinion, the power to create secret reserves is being improperly used by directors.

From the *dicta* in the same case it may also be assumed that an auditor is not bound to disclose in his report the fact that secret reserves exist, provided he is satisfied that the reserve is employed to the benefit and in the interests of the company as a whole. "The purpose of the Balance Sheet is primarily to show that the financial position of the company is at least as good as there stated and not to show that it is not or may not be better" (*Buckley, J.*).

It has already been stated that, in most circumstances, directors of limited companies have ample power to use their discretion in making reserves prior to the distribution of profits. It may be added that, by S. 21 of the *Finance Act*, 1922, as amended by the *Finance Acts*, 1927 and 1928, certain companies withholding income from distribution by carrying amounts to reserve or otherwise, with a view to enabling shareholders to avoid payment of sur-tax, may themselves become liable to the tax.

Past Losses.—The examination candidate is prone to declare with emphasis that past losses brought forward must be made good out of current profits before the distribution of dividends is possible. As a business policy, this is no doubt wise, but it cannot be said that companies are always legally obliged to make good past losses before declaring dividends. It would appear that continuity cannot be claimed for the Profit and Loss Account, and the Courts have refused to lay down a rule that the profits of a current year may not be distributed if a debit balance from previous years remains to be dealt with (*Ammonia Soda Co.* v. *Chamberlain*, [1918]; *Stapley* v. *Read*, [1924]).

IV. Appropriation Account.

Some examination candidates treat the Appropriation Account as a distinct account under a separate heading, whereas it is merely the final section of the Profit and Loss Account. Some companies refer to this statement as the *Net Profit Account*, or the *Net Revenue Account*.

An Appropriation Section is particularly necessary in the case of limited companies, but it is also applicable and valuable in partnership accounts. By carrying down the balance of net profit for the year to an Appropriation Section, the Profit and Loss Account is freed from the details showing the manner in which that profit is appropriated, permitting the Profit and Loss Account to give a clear view of the gross revenue earned for the year, the expenses incurred in earning that revenue, the net amount of the revenue earned, and facilitating comparisons with previous years.

When preparing solutions to examination questions, some candidates lose marks because they debit the Profit and Loss Account with all dividends paid, transfers to reserve, manager's commission on net profits, and the like, and credit the account with the balance brought forward from last year. This procedure does not, of course, affect the net balance available for distribution, but it reveals want of knowledge of modern practice, and it defeats the object of the Profit and Loss Account, which is to show at a glance the result of the current year's working.

Again, some candidates prepare an appropriation section but mar its effectiveness by debiting it with such items as depreciation, debenture interest, and the like, which are *charges against* the profit for the year, and not *appropriations of profit* available for distribution.

Illustration.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED JUNE 30, 19...

(APPROPRIATION SECTION.)

Dr.		£	s.	d.		Cr.	£	s.	d.
19... June 30	To Transfer to Reserve Account	2,500	0	0	19... June 30	By Balance brought down, being net profit for the year	18,786	0	0
" 30	" Dividend for Half-year to Dec. 31, 19.., on 6 % Preference Shares ..	2,500	0	0	" 30	" Balance brought forward from last account	5,538	0	0
" 30	" Interim Dividend at 10 % on Ordinary Shares paid Dec. 21, 19..	6,200	0	0					
" 30	" Preliminary Expenses written off..	962	0	0					
" 30	" Balance carried down	12,162	0	0					
		£ 24,324	0	0			£ 24,324	0	0
					19... June 30	By Balance brought down	12,162	0	0

In practice, the entries recording the appropriations made in the above account would be made *direct* from the Profit and Loss Account. If journalised, the entries would be as follows :—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... June 30	Profit and Loss Account (Appropriation Section) Dr.		3,462	0	0			
	To Reserve Account					2,500	0	0
	,, Preliminary Expenses Account					962	0	0
	Being amount transferred to Reserve and amount written off Preliminary Expenses as per resolution of Directors.							
,, 30	Profit and Loss Account (Appropriation Section) Dr.		8,700	0	0			
	To Interim Dividend (Ordinary Shares)					6,200	0	0
	,, Dividend on 6 % Preference Shares					2,500	0	0
	Being transfer of dividends paid on the above shares during the year ended June 30, 19...							

The Directors' Report must contain a statement showing how the Board proposes to deal with the balance of profit shown by the Appropriation Account as being available for distribution (see pp. 359–361).

EXAMINATION QUESTIONS.

1. Indicate the difference between: (1) Receipts and Payments Account; (2) Income and Expenditure Account; (3) Revenue Account; (4) Profit and Loss Account. (*Incorporated Secretaries.*)

2. Briefly state the considerations which would guide you in allocating expenditure as between Capital and Revenue. (*Royal Society Arts.*)

3. "The nice adjustment of Expenditure between Capital and Revenue is often a difficult task."

In illustration of the above statement, describe two imaginary items of Expenditure incurred by a limited company which need so adjusting.

Give the entries you would make and your reasons for the treatment you adopt. (*Royal Society Arts.*)

4. Explain the principles you would adopt when allocating the undermentioned expenditure as between Capital and Revenue: (*a*) Stock (valued at £23,000) destroyed by fire, for which £24,860 was received from the Insurance Company. (*b*) Installation of electric power in a factory in place of steam. (*c*) Structural alterations to freehold factory. (*d*) Amortisation of lease. (*e*) Loss on sale of machinery. (*Chartered Accountants.*)

5. Set out shortly the several matters calling for special attention before the closing of the books at a balancing period. (*Chartered Secretaries.*)

6. How should "Goods in Transit" be treated for Balance Sheet purposes? (*London Association Accountants.*)

7. In some trades, goods are delivered accompanied by invoices dated two or three months ahead.

Does this practice call for any special treatment from an auditor's point of view? If so, describe the procedure you would adopt. (*Chartered Accountants.*)

8. Select *one only* of the undermentioned cases and state how stock should be taken, and the evidence you would require as to its existence and the value placed upon it: (*a*) Tobacco importer with goods in bond. (*b*) An export merchant with unsold consignments outstanding abroad. (*c*) A contractor with several uncompleted contracts in progress. (*Royal Society Arts.*)

9. The following items appear in the Balance Sheet of a limited company: Stock of Goods, Produce and Debts in Africa, and Goods in Warehouse in Liverpool and elsewhere, £2,239,636 9s. 2d.; Shipments in Transit Outward, £96,052 14s. 7d.; Produce in Transit Homeward and in Store in Liverpool and elsewhere, £209,224 14s. 6d.; Investments in, and Accounts Current with, Allied and Subsidiary Companies, £7,640,003 16s. 7d.; Miscellaneous Investments, £110,855 6s. 8d.

In auditing the books of the company, how would you verify the correctness of these figures? (*Incorporated Accountants.*)

10. Would you defend, and if so, on what grounds, the non-presentation by a manufacturing company of its Trading and Profit and Loss Accounts at its annual meeting? (*Chartered Accountants.*)

11. Is the Profit and Loss Account, as set out below, properly drawn up? If not, submit the account as you would present it.

PROFIT AND LOSS ACCOUNT, DECEMBER 31ST.

Dr.	£		£	Cr. £
To Salaries	520	By Stock	18,200	
" Depreciation	1,401	" *Less* January 1st	17,400	
" Purchases	42,600			800
" Returns	302	" Interest on investments	3,400	
" Discounts	421	" *Less* Loss on Sale of Investments	900	
" Dividend paid	3,842			2,500
" Directors' Fees	1,000	" Balance from last year's account		4,321
" Trade Expenses	1,200	" Sales		59,940
" Dividend (5 % for year)	6,200	" Error in Books		120
" Manufacturing Wages	3,280	" Unclaimed Dividends		321
" Transfer to Reserve Account	4,000			
" Balance carried to Balance Sheet	2,876			
	£68,002			£68,002

(*Royal Society Arts.*)

12 The following is the Trial Balance of a company on December 31st:—

	Dr.	Cr.
Stock, January 1st	2,000	
Book Debts	2,000	
Plant and Machinery	1,000	
Wages	500	
Salaries	200	
Preference Shares		2,500
Ordinary Shares		2,500
Freeholds	3,000	
Creditors		1,000
General Reserve		1,000
Travelling Expenses	250	
Purchases	10,000	
Sales		15,000
Cash	3,050	
	£22,000	£22,000

Stock on December 31st was £2,500.

It is resolved: To write 10 % off Plant and Machinery; to reserve on Bad and Doubtful Debts Account 10 % off Book Debts; to place £100 to a Bonus Fund for the Staff; to place £1,250 to General Reserve; to pay 5 % on the Preference Shares, *less* tax; to pay 6 % on the Ordinary Shares, free of tax; and to carry the balance forward.

Prepare the Trading and Profit and Loss Account for the year, and the Balance Sheet as at its close, after appropriating the profits as directed. (*Chartered Accountants.*)

13. The Alpha Manufacturing Co., Ltd., had a nominal capital of £20,000, divided into 12,000 "A" shares and 8,000 "B" shares of £1 each, of which 10,000 "A" and 5,000 "B" shares were issued and fully paid up.

The Company's articles provided that the profits should be divided as follows, so far as the general meeting might decide: (1) In payment of a cumulative dividend of 10 % on the "A" and 20 % on the "B" shares. (2) In payment of a non-cumulative dividend of 15 % on the "B" shares. (3) In payment of a non-cumulative dividend of 7½ % on the "A" shares. (4) In payment of a further dividend *pro rata*, but so that the dividend on each "B" share should be twice that on each "A" share.

The general manager was entitled to a bonus of £10 for each 1 % dividend paid on the "A" shares above 10 %.

The profits for the year 19.. amounted to £9,000, and there was an undistributed balance from 19.. of £3,500.

The general meeting decided to pay the dividends under (1), (2), and (3) above, and a further dividend under (4) of 7½ % on the "A" and 15 % on the "B" shares; and, after providing for the general manager's bonus, to place one-half of the balance to Reserve Fund, and carry the other half forward to next year.

Make out the Appropriation Account. (*Chartered Accountants.*)

14. Prepare from the following figures a Balance Sheet, Trading Account, and Profit and Loss Account as at December 31, 19.. :—

Factory Buildings (Cost), £30,000; Leasehold Properties, £24,000; Wages (Factory), £72,800; Salaries (Office), £7,900; Ground Rents purchased, £6,700; Advertising Expenses, £17,000; Sundry Creditors, £26,606; Sundry Debtors, £34,000; Bills Receivable, £23,200; Law Charges, £300; Repairs and Replacements (Factory), £1,700; Loose Tools, £2,800; Travelling Expenses, £4,102; Capital Account: 100,000 £1 shares issued Ordinary, fully paid; 50,000 £1 shares issued Preference, 10s. paid; Sales, £404,000; Purchases, £202,000; Furniture and Fixtures (Office), £3,010; Stock at January 1, 19.., £38,000; Freight and Insurance, £1,900; Bank Charges, £73; Cash at Bank, £3,000; Profit and Loss Account, Credit Balance, January 1, 19.., £23,000; Goodwill, £30,000; Returns (Sales Account), £4,002; Discounts (Dr.), £1,990; Discounts (Cr.), £3,080; Plant and Machinery, £27,000; Investments, £46,209.

The Stock at the end of the period was valued at £35,000.

In the preparation of the accounts allow for Depreciation as follows: 50 % of the Tools Account, 5 % of the Furniture, 10 % of the Plant.

Create also a Reserve of 7½ % on the value of the Leaseholds and 20 % on the value of the Investments.

Provide also for a further £10,000 due on Advertising Account. (*Chartered Secretaries.*)

15. A company purchased a business as a going concern on January 1, 19.., with the right to the profits from October 1st previous. The Capital is: 5 % Preference Shares, £50,000; 6 % Preferred Ordinary Shares, £50,000; Deferred Ordinary Shares, £24,800. The year's profits to September 30th following the date of purchase are found to be £7,664. What appropriation of such profits should you make? (*Chartered Accountants.*)

16. Criticism is sometimes made that audited Balance Sheets and Accounts do not show clearly the appropriation of the balances at the credit of Profit and Loss Accounts. Give an instance (dealing with the figures of any account with which you may be familiar) of the manner in which in your opinion they should be presented to shareholders. (*Incorporated Accountants.*)

17. Give a short description of each of the following methods of providing for depreciation: Fixed Instalment System; Reducing Instalment System; Depreciation Fund System; Insurance Policy System.

Which, if any, of the foregoing systems of providing for depreciation would you recommend should be adopted in the case of a stud of horses? (*London Association Accountants.*)

18. Describe and contrast: (1) A Reserve which is a charge against profits; and (2) a Reserve which is an appropriation from profits.

Give an illustration of a reserve of each class, and state how they should appear in the accounts of a limited company, and describe an auditor's duty in relation thereto. (*Chartered Accountants.*)

19. What do you understand by an Appropriation Account? Should any of the following items appear in such an account: Salary of Manager; Interest on Debentures; Managing Director's Remuneration; Dividend on Ordinary Shares; Transfer to Reserve Account? Illustrate your answer with a *pro-forma* Appropriation Account, inserting imaginary figures. (*Incorporated Secretaries.*)

20. Give two examples demonstrating how capital reserves—as distinguished from reserves created out of revenue—may arise.

Illustrate your answer by giving the entries you would make in the books and published accounts in respect of the examples you select. (*Royal Society Arts.*)

21. Describe the expenditure which, in your opinion, may be legitimately debited to Preliminary Expenses Account by a newly registered limited company.

State how you would deal with this expenditure in the books and published accounts of the company. (*London Chamber Commerce.*)

22.

PROFIT AND LOSS ACCOUNT, DECEMBER 31, 19..

	£		£
To Balance from 19.. ..	3,682	By Balance from Trading Account	14,766
,, Depreciation	1,521	,, Increase in Stock ..	1,241
,, Manager's Commission on net Trading Profit	393	,, Undrawn Dividends ..	200
,, Loss on Sale of Investments, less Interest received	1,721	,, Transfer from Bad Debt Reserve	250
,, Sales Returns	940		
,, Directors' Fees	1,000		
,, Proposed 5 % Dividend for year 19..	5,000		
,, Transfer to Reserve ..	1,000		
,, Balance carried down	1,200		
	£16,457		£16,457

If, in your opinion, the above Profit and Loss Account is not correctly drawn up, criticise and amend it. (*Royal Society Arts.*)

The above account is correctly presented, and meets the need of the case, if we assume that the Cricket Ground and Pavilion are lent to the Club free of charge, and that no subscriptions or liabilities are outstanding.

But the student must realise that, in many instances, such an account does not reveal the *actual income* for the period it purports to cover. It includes the balance from the previous period, and may also include receipts and payments belonging to previous or succeeding years, e.g. subscriptions or rent in arrear or paid in advance. Furthermore, capital receipts and expenditure may be included, and outstanding liabilities and income be disregarded. Thus, in the above illustration, assume for the sake of argument that the Club had acquired the Pavilion for £60, and that a subscriber had paid £4 4s., representing £2 2s. subscription for the current year and £2 2s. outstanding for the previous year; yet the whole of the £4 4s. would be included in the item "Subscriptions, £590 2s.," and the capital expenditure of £60 would have appeared as a payment.

If the receipts and payments are numerous, a Tabular Cash Book will save the treasurer considerable trouble when preparing his account.

II. Income and Expenditure Accounts.

As pointed out above, a Receipts and Payments Account does not necessarily show the actual income for the period covered by the account. It is the object of an Income and Expenditure Account precisely to ascertain and show that actual income. In other words, the function of this account, as employed by non-trading concerns, is exactly the same as that of the Profit and Loss Account of a commercial undertaking. It should include the whole of the income and expenditure appertaining to the period covered, no matter whether it is actually received or paid, or not. Examination candidates not infrequently state that an Income and Expenditure Account should include all income and expenditure *due for payment* within the period. This is incorrect. The account should include all income and expenditure appertaining to the period *whether due for payment or not*. That being so, apportionment must be made of any accruing income applicable to the period, and also of any outstanding charges for the period not yet due for payment. It is clear that these accounts pre-suppose double-entry book-keeping and demand a correlative Balance Sheet.

A company to which the *Companies Act*, 1929, applies is obliged to lay before a General Meeting at least once in every calendar year an Income and Expenditure Account if it does not present a Profit and Loss Account.

The construction of an Income and Expenditure Account being in essence the same as that of a Profit and Loss Account, it follows that the income will appear on the credit, and the outgoings properly chargeable against the income on the debit, side of the account. And

since all outstanding income and liabilities have been taken into account, it also follows that the account must be conjoined with a Balance Sheet disclosing the financial position at the end of the period. The balance of the Income and Expenditure Account represents the surplus or deficiency for the period, and must be added to, or deducted from, the "Capital" or "Surplus" fund in the Balance Sheet.

The Income and Expenditure Account forms an integral part of the accounts in a system of double-entry book-keeping, just as a Profit and Loss Account does, whereas a Receipts and Payments Account is a cash statement forming no part of the book-keeping system.

Inspection of the published accounts of non-trading institutions, societies, and clubs reveals an astonishing variety of statements which are frequently as inaccurate and misleading in results as they are unhappy in nomenclature, ranging as that does from "Cash Account," "Receipts and Payments," "Receipts and Expenditure," "Income and Expenditure," "Income and Payments" to "Balance Sheet"! It may be well, therefore, to recapitulate briefly the essential differences between Receipts and Payments Accounts, and Income and Expenditure Accounts.

Receipts and Payments Account.	*Income and Expenditure Account.*
This is nothing more than a classified summary of the Cash Book for a stated period. It deals with all cash received and paid during the period, irrespective of the year to which it may relate. No attempt is made to arrive at the *income* for the period, and no distinction is made between Capital and Revenue receipts or payments. The resulting balance represents the unexpended cash in hand or at the bank. Where no property or assets (other than cash) is held, and no liabilities exist, such an account meets the needs of the case, and no Balance Sheet is necessary.	This account shows the *actual income* for the current period only, together with the expenditure chargeable against that income, whether such income or expenditure is due or has been discharged or not within the period. The resulting balance shows the extent to which the income exceeds or falls short of the expenditure for the period. Since the account deals with outstanding income and/or expenditure, it must be accompanied by its relative Balance Sheet.

Illustration.—The following particulars relate to The Muggleton Horticultural Society for the year ended December 31, 19.. :—

At the beginning of the year.—Cash in Bank, £189; War Loan in hand, £100 (at cost), accrued interest thereon, £2 10s.; Tents, Staging, etc., as per valuation, £125; Subscriptions Outstanding, £24 (received during year); Tradesman's Bill for Prizes Outstanding, £9 (paid during year).

During the year.—Subscriptions and Donations Received, £324; Exhibitors' Entrance Fees, £89 10s.; Advertisements in Show Catalogue Received, £36; Admission Money to Show, £129 8s.; Cost of Prizes and Competitions, £142 4s. 6d.; Sale of Catalogues, £3 6s. 6d.; Cost of Band, £28; Printing and Stationery, £38; Rent paid for Extra Staging and Chairs, £10; Entertainment Tax, £8 4s.; Police and Labour, £10 19s. 6d.; Judges' Fees, £5 5s.; Cost of New Marquee purchased, £150; Entrance Fees, Sports, and Competitions £41; Chair Hire received, £2 6s.; Proceeds of Concert, £12 8s. 6d.; Cost of New Staging and Show

Tables purchased, £36 10s.; Refreshments: Cost, £72 1s. 4d.; Sales, £84 9s.; Interest on War Loan (18 months), £7 10s.; Donations made to: Muggleton Cottage Hospital, £100; Loamshire County Hospital, £100; War Loan purchased (December 29th), cost, £101.

At end of year.—Subscriptions Outstanding, £21; Exhibitors' Entrance Fees Outstanding, £10 10s.; Advertisements in Show Catalogue Outstanding, £8 9s. 6d.; Printing and Stationery, amount owing, £3 2s. 6d.

The Secretary circulated the following account to members and subscribers :—

Muggleton Horticultural Society.

BALANCE SHEET, 19...

	£	s.	d.		£	s.	d.
Balance from last year	189	0	0	Prizes and Competitions	142	4	6
Subscriptions and Donations	324	0	0	Cost of Band	28	0	0
Exhibitors' Fees (Show)	89	10	0	Printing and Stationery	38	0	0
Competition Fees (Sports)	41	0	0	Rent of Staging and Chairs	10	0	0
Proceeds of Concert	12	8	6	Entertainment Tax	8	4	0
Profit on Refreshments	12	7	8	Police and Labour	10	19	6
Interest (War Loan)	7	10	0	Judges' Fees	5	5	0
Receipts from Advertisements . ..	36	0	0	Marquee Purchased	150	0	0
Admission Money	129	8	0	New Staging and Show Tables ..	36	10	0
Sale of Catalogues	3	6	0	Donations :—			
Chair Hire Received	2	6	0	Muggleton Cottage Hospital ..	100	0	0
				Loamshire County Hospital ..	100	0	0
				War Loan Purchased	101	0	0
				Balance carried down	116	13	8
	£846	16	8		£846	16	8
Balance brought down	116	13	8				

It is needless to say that the above Statement is not a Balance Sheet. It is merely an analysis of the cash receipts and payments for the year. It does not show the financial result of the Society's Annual Show, neither does it disclose the financial position of the Society at the close of the year. As the Society possesses property and has outstanding assets and a liability, a Balance Sheet should be prepared. Furthermore, the chief object of the Society being to hold an annual show, the accounts should disclose the actual financial result of each show. Before proceeding further, the student is advised to prepare accounts from the figures given for comparison with those that follow.

In order to draw up a Balance Sheet, the financial position at the beginning of the year must be established. This appears to have been as follows :—

ASSETS.	£	s.	d.
Cash at Bank	189	0	0
War Loan and Interest accrued	102	10	0
Tents, Staging, etc.	125	0	0
Debtors for Subscriptions	24	0	0
	440	10	0
Less Liability—			
Tradesman's Bill (Prizes)	9	0	0
Capital (or Surplus) Fund	£431	10	0

An Income and Expenditure Account and a Balance Sheet can now be prepared as under :—

Muggleton Horticultural Society.

INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
To Prizes and Competitions	133	4	6	By Subscriptions and Donations ..	321	0	0
,, Cost of Band..	28	0	0	,, Exhibitors' Fees (Show)	100	0	0
,, Printing and Stationery	41	2	6	,, Entrance Fees (Sports)	41	0	0
,, Rent of Staging and Chairs ..	10	0	0	,, Gate Money (Show)	129	8	0
,, Entertainment Tax	8	4	0	,, Advertisements in Catalogue ..	44	9	6
,, Police and Labour	10	19	6	,, Sale of Catalogues	3	6	6
,, Judges' Fees	5	5	0	,, Chair Hire	2	6	0
,, Donations :—				,, Proceeds of Concert	12	8	6
Muggleton Cottage Hospital ..	100	0	0	,, Refreshment Sales £84 9 0			
Loamshire County Hospital .	100	0	0	*Less* Purchases, etc. 72 1 4			
,, Balance carried to Capital Fund	234	10	8		12	7	8
				,, Interest on War Loan	5	0	0
	£671	6	2		£671	6	2

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Capital Fund :—				Tents, Staging, etc. .. £125 0 0			
As on Dec. 31, 19.. .. £431 10 0				Additions during the year 186 10 0			
Surplus from Income and Expenditure Account 234 10 8					311	10	0
	666	0	8	Sundry Debtors	39	19	6
Sundry Creditor	3	2	6	War Loan at Cost	201	0	0
				Cash at Bank	116	13	8
	£669	3	2		£669	3	2

EXAMINATION QUESTION.

The account set out below has been submitted to you for audit. If you do not approve of it, criticise and amend it.

Loamshire Entomological Society.

INCOME AND EXPENDITURE ACCOUNT, DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
To Entrance Fees (20 at £10 10s.) ..	210	0	0	By Salaries and Wages	675	0	0
,, Fees for Life Membership (5 at £52 10s.)	262	10	0	,, Secretary's Salary	350	0	0
,, Annual Subscriptions £1,564 0 0				,, Rent, Rates, etc..	1,264	10	6
,, Ditto, paid in advance 65 0 0				,, Printing and Postages	36	18	
	1,629	0	0	,, Repairs to Premises	124	1	4
,, Interest on War Loan	77	10	0	,, Interest on Bank Loan	57	7	4
,, Sundry Receipts	62	8	6	,, Balance carried down..	970	4	1
,, Balance from last year	1,236	13	4				
	£3,478	1	10		£3,478	1	10
To Balance brought down	970	4	1				

TREASURER'S NOTES.—The Subscriptions in arrear amount to £121. Sundry Tradesmen's bills, £42 4s. 6d., were outstanding on December 31st, but have since been paid. The Secretary's salary, though sanctioned by

resolution of the Committee, has not yet been paid. The War Loan (1929–47), £2,000, was purchased at 98½. The lease of the Club premises (16 years to run) cost £2,124. The balance of the Bank Loan now outstanding is £1,000, secured by mortgage on the leasehold premises. (*Chartered Accountants, Intermediate.*)

Solution.

(*a*) *Criticism.*—The account submitted is not an Income and Expenditure Account; it is merely an analysis of the cash receipts and payments for the year, except that the Secretary's salary (£350) has been included as a payment, whereas the Treasurer's note states that the amount is still outstanding. It appears, therefore, that the Cash in hand should be £1,320 4s. 1d., and not £970 4s. 1d. as stated.

(*b*) *Amendment.*—As this Society possesses assets and is liable for outstanding debts, the accounts should be presented in the form of an Income and Expenditure Account showing the actual income of the year, and a Balance Sheet disclosing the financial position at the close of the year.

Preliminary to the preparation of these accounts, the position of affairs at the beginning of the year must be ascertained as follows:—

ASSETS.	£	s.	d.
Cash at Bank	1,236	13	4
War Loan at 98½	1,970	0	0
Lease	2,124	0	0
	£5,330	13	4
Less Liability—			
Bank Loan	1,000	0	0
Capital (*or Surplus*) *Fund*	£4,330	13	4

Loamshire Entomological Society.

INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..

DR.	£	s.	d.	CR.	£	s.	d.
To Salaries and Wages	675	0	0	By Entrance Fees	210	0	0
,, Secretary's Salary	350	0	0	,, Fees for Life Membership ..	262	10	0
,, Rent, Rates, etc.	1,264	10	6	,, Annual Subscriptions	1,685	0	0
,, Printing and Postages	36	18	7	,, Interest on War Loan	77	10	0
,, Repairs to Premises	124	1	4	,, Sundry Receipts	62	8	6
,, Interest on Bank Loan	57	7	4	,, Balance carried to Capital Fund, being excess of expenditure over income	252	13	9
,, Expenses outstanding	42	4	6				
£	2,550	2	3	£	2,550	2	3

BALANCE SHEET, DECEMBER 31, 19..

	£	s.	d.		£	s.	d.
Capital Fund as on December 31, 19.. £4,330 13 4				Lease at Cost	2,124	0	0
Less Income and Expenditure Account 252 13 9	4,077	19	7	War Loan at Cost	1,970	0	0
Sundry Creditors	457	4	6	Sundry Debtors	121	0	0
Bank Loan (secured on leasehold property)	1,000	0	0	Cash at Bank	1,320	4	1
£	5,535	4	1	£	5,535	4	1

NOTE.—No provision has been made for wastage of the Lease.

Hospital Income and Expenditure Accounts.—Specified forms of account, drafted by a well-known chartered accountant, must be adopted by hospitals desiring to participate in the "King Edward" and similar Hospital Funds.

III. Revenue Accounts.

The object of a Revenue Account is to ascertain the net profit, or income, for the financial period to which it relates, and it can be prepared only from a set of books kept on double-entry principles.

The term "Revenue Account" is used chiefly by Assurance Companies, and non-trading undertakings which derive their income from Investments, Royalties, Rents, and similar sources. Parliamentary companies, under statutory obligation to employ the double-account system, necessarily adopt the form of Revenue Account prescribed by the Statute under which they work. Examples of such accounts as published by Railway, Gas, Electric, and similar undertakings will be found in Chapter XIII.

The distinction between the terms "Income and Expenditure Account," "Profit and Loss Account," and "Revenue Account" is purely technical, and is sometimes urged to the point of pedantry. Since the construction of these accounts, and the objects served by them are practically identical, no further treatment need be accorded them here.

EXAMINATION QUESTIONS.

1. Explain the difference (if any) between a Revenue Account, an Income and Expenditure Account, and a Receipts and Payments Account. (*London Chamber Commerce.*)

2. Frequently so-called Balance Sheets are exhibited, particularly by charitable societies, whereas really they are only Cash Accounts. What further is necessary to make them complete Balance Sheets, showing the true financial position? (*Chartered Accountants.*)

3. Why is a Receipts and Payments Account unsatisfactory as an indication of the result of carrying on a business for a period? (*Chartered Accountants.*)

4. A war charity fund received for the six months ended December 31, 19.., £14,676 9s. 7d., and interest on investments, £180 19s.

The administrative expenditure amounted to £3,838 10s. 6d., and included £1,699 5s. 10d., the cost and expenses of making appeals for funds. The Expenditure on Relief amounted to £5,213 9s. 11d., and on Loans to £781. The latter were not regarded as recoverable, but it was deemed advisable to leave the accounts open. At the commencement of the period there was £2,000 invested in 4½ % War Loan which cost £1,977 5s., and this was unrealised at the date you are instructed to prepare a Balance Sheet and Income and Expenditure Account (January 1, 1917). The cash at the Bank at July 1, 1916, was £505, and at December 31, 1916, the various committees were authorised to spend up to the following limits: A, £3,416 4s. 2d.; B, £2,800 3s. 10d.; C, £1,100 5s. 2d.

Add to the accounts you draft, a report expressing your opinion on the situation as disclosed by them. (*Incorporated Accountants.*)

5. The following Statement of Accounts of the Blankshire Benevolent

Charity was submitted as shown for adoption at the annual meeting. You are invited to criticise it.

STATEMENT OF ACCOUNTS FOR THE YEAR ENDED JUNE 30, 19...

RECEIPTS.	£	s.	d.	EXPENDITURE.	£	s.	d.
To Balance	457	6	5	By Annuities	805	0	0
,, Interest on Investments	270	18	4	,, Salary—			
,, Donations	383	12	6	Secretary	25	0	0
,, Special Appeal	182	14	0	Treasurer	25	0	0
,, Income Tax returned	24	13	8	,, Incidentals	0	18	3
,, Stamps overcharged	3	0	0	,, Printing	8	3	6
,, Bank Interest	8	19	0	,, Chief Rent	5	9	4
,, Amount Banked in error	1	1	6	,, Law Charges	9	8	0
				,, Bank Commission	2	8	9
				,, Sundries	8	12	2
				,, Balance in Bank	442	5	5
	£1,332	5	5		£1,332	5	5

PRESENT FUNDS.

		Cost.		
2½ %	Midland Railway Debenture Stock	1,168	6	8
3 %	London and North-Western Railway Debenture Stock	1,255	18	4
4 %	Lancashire and Yorkshire Guaranteed Stock	923	16	9
3 %	Manchester Corporation Stock	514	1	10
3½ %	Blackpool Corporation Stock	500	0	0
3¾ %	Stockport Corporation Stock	2,500	0	0
	Mortgages at 4 %	3,300	0	0
		£10,162	3	7

Audited and certified correct,
HERBERT TRUSTEM.

The Securities upon which the present Funds of the Institution are invested were produced to and examined by us, and we certify that they are in perfect order and in safe custody.

WILLIAM T. SUPPLETON, *Chairman.*
JAMES UNION, *Vice-Chairman.*

(*Incorporated Accountants.*)

6. From the following Receipts and Payments Account of a charitable institution, and the subjoined information, prepare General Income and Expenditure Account for the year ended December 31, 19.. :—

RECEIPTS AND PAYMENTS ACCOUNT.

19...		£	£	19...		£	£
Jan. 31.	To Balance—			Dec. 31.	By Payments to Pensioners ..		1,265
,,	Cash on deposit ..	500		,,	,, Rent, three quarters		75
,,	Cash on current account	116		,,	,, Office Expenses and Salaries		275
,,	Cash in hand	7		,,	,, Collector's Commission ..		37
			623	,,	,, Printing Year Book, etc ..		26
Dec. 31	,, Donations and Subscriptions		1,272	,,	,, Postages		18
,,	,, Legacies		400	,,	,, Gratuities from Special Fund		143
,,	,, Special Fund Donations ..		170	,,	,, Investment in £500 Birmingham 3 % Stock		300
,,	,, Interest on Investments ..		135	,,	,, Balance—		
,,	,, Interest on Deposit		24	,,	Cash on deposit ..	£400	
				,,	Cash on current account	73	
				,,	Cash in hand	12	
							485
			£2,624				£2,624

The committee of management resolve that one-half of legacies received shall be treated as income, the remainder being capital, and that the "Special Fund" should be separated from the "General Funds." Bring into account income tax recoverable. A quarter's rent was unpaid at December 31st. Sundry persons owed £15 for advertisements in the Year Book. (*Chartered Accountants.*)

Chapter V

THE BALANCE SHEET

When the figures necessary for the compilation of the Trading and Profit and Loss Accounts have been extracted from the Trial Balance, the remaining items should consist of the details necessary for the construction of the Balance Sheet. Items of a like nature must be grouped together, since the totals only of the generic groups can be dealt with in the Balance Sheet. In order that this may be done, it is customary to extract the balances from the various ledgers on separate lists, the totals only of the several lists being entered in the Trial Balance. Thus the Sales Ledgers' balances will furnish the total "Sundry Debtors"; the Bought Ledgers' balances, the total "Sundry Creditors"; the Investment Ledger balances, the total "Investments," and so on. The strictest care must be taken that the grouping of the items is not misleading, as it will be, if heterogeneous assets and liabilities are lumped together. The material thus accumulated and classified will furnish the framework of the Balance Sheet, but much more must be done before the document can be regarded as complete.

Basis of Balance Sheet.—The "Statement of Affairs" prepared in insolvency proceedings is analogous to a Balance Sheet. But in a Statement of Affairs the assets are valued at their estimated break-up values in order that creditors may forecast the result of immediate realisation, whereas in a Balance Sheet the values of the assets are their values to the business as a going concern. The definition of a Balance Sheet, usually tendered by the student as "a statement of assets and liabilities," cannot be considered satisfactory in view of the fact that items may be included in it that do not belong to either category, e.g. premiums on the issue of shares, debit balance of Profit and Loss Account, preliminary expenses, reserves, etc. A better definition is that *a Balance Sheet is a classified summary of the ledger balances remaining after closing all revenue items into the Profit and Loss Account.*

As we have seen, the elimination from the Trial Balance of the Trading and Profit and Loss items leaves us with the framework of the Balance Sheet. But before that framework can be utilised other things must be done. The liabilities must be carefully scrutinised to ensure that all outstanding debts have been brought into account. Where available, the Stores Inward Book kept by the store-keeper

should be checked to ensure that the invoices representing the latest deliveries of goods have been properly posted, and that goods represented by invoices entered immediately after the close of the year have not been included in the stock valuation. If no Stores Book is kept, the Carrier's Book, or Warehouseman's Rough Book, or similar records may serve the same purpose. Examination of the Bills Payable Book will ensure that all outstanding bills are properly recorded in the financial books. As regards limited companies, the Directors' Minute Book may afford evidence of contingent or other liabilities which need to be recorded. The assets, also, need careful scrutiny to ensure that the values placed upon them are justified, and that all due provision for known waste has been made.

Single and Double Account Methods.—Balance Sheets prepared by ordinary commercial undertakings in the form of a single comprehensive statement are said to be prepared on the *Single Account System*. The *Double Account System*, which applies to the parliamentary companies under statutory obligation to adopt it, or to such concerns as may voluntarily adopt it, is discussed in Chapter XIII. A Balance Sheet prepared under the latter system is in two sections. In the first section, all expenditure upon fixed assets is marshalled against the relative share capital and debentures raised for the undertaking, and the balance there shown is carried to the second section, which is concerned with the floating assets, liabilities, reserves, depreciation funds, stores, and the like.

Limited Companies and Balance Sheets.—The *Companies Act*, 1929, makes it compulsory for every company within the meaning of that Act to draw up and lay before the company in General Meeting not later than eighteen months after incorporation and, subsequently, once at least in every calendar year a Balance Sheet made up to a date not earlier than nine months prior to the meeting, or, in the case of a company carrying on business or having interests abroad, not earlier than twelve months before the meeting. The Board of Trade may, in individual cases, and for special reasons, extend the above periods. The Act also provides for the Balance Sheet to be signed on behalf of the board of directors by at least two directors, or by the sole director. Provision is also made for audit. A copy of the Balance Sheet and certain relevant documents, including a copy of the auditors' report, must be sent, not less than seven days before the date of the meeting, to all persons entitled to receive notices of general meetings of the company, except in the case of a private company, which need not send copies unless its articles provide that they shall be sent. Provision is also made in the case of a public company for any member or debenture holder to receive free copies on demand; and in the case of a private company for any member to receive a copy on payment. (See pp. 268 and 499.) The Balance Sheet must disclose certain particulars, details of which are enumerated at pp. 497 *et seq*.

Responsibility for the Balance Sheet.—The accounts of private firms are of concern to the partners only. The responsibility for the Balance Sheet of a limited company rests upon the Directors of the Company. It is their Balance Sheet, in token whereof, as we have seen, the Act of 1929 requires that the signatures of two of their number shall be appended to it "on behalf of the Board" (S. 129). It is true that the Auditors' certificate also appears at the foot of the Balance Sheet. But Auditors cannot dictate its form, unless it fails to comply with the Act (see p. 285) or it is misleading or inaccurate, nor do they accept responsibility for the values placed upon the assets. Auditors do not certify these values; indeed, they cannot, since these values are frequently matters not of actual fact, but of opinion. An auditor has to report in specified terms that he has obtained all the information and explanations he has required, and that in his opinion the Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of his information, and as shown by the books of the company. But up to the present there is no guidance as to what legal significance is to be attached to the phrase "true and correct view," so long as the details specified in the Act are duly stated.

Form of Balance Sheet.—The draftsman of the Balance Sheet of a private partnership must study the Articles of Partnership, which, almost certainly, will contain clauses affecting the accounts, e.g. in such matters as fixed capital, drawings, interest, loans, etc. Hospitals desiring to participate in King Edward's Hospital Fund, and the Hospital Saturday and Sunday Funds, must adopt the form prescribed by the committee administering those funds. As regards public companies, if the undertaking is amenable to any particular Act of Parliament, as, for example, are Railway Companies (*Railway Accounts and Returns Act*, 1911),* Assurance Companies (*Assurance Companies Act*, 1909), Building Societies (*Building Societies Act*, 1894), Gas Companies (*Gas Works Clauses Act*, 1871), etc., the statutory form prescribed by the particular controlling Act must, of course, be followed. Apart from parliamentary companies, there is no prescribed form of Balance Sheet. It is difficult to imagine a stereotyped form that would suit all and every type of commercial or financial undertaking. Unification is, in fact, impossible.†

A Balance Sheet is a condensed and classified list, taken out upon a sheet of paper, of the balances remaining open in a set of books after the Trading and Profit and Loss Accounts have been prepared and

* As modified by the order of the Minister of Transport, dated 27th December, 1928.

† Article 81 of Table A in the First Schedule to the *Companies Act of* 1862 contained a form of Balance Sheet. But that effort at formulation was not very happy, and was not repeated in subsequent Acts.

closed. It is not a ledger account, and balances cannot therefore be transferred to it. The item occasionally seen in some published Profit and Loss Accounts, "Balance transferred to Balance Sheet," is therefore unfortunate. The Profit and Loss Account is a ledger account, but the Balance Sheet is not.

In America, and on the Continent, and also, to some extent, in Scotland, the assets are placed on the left-hand side, and the liabilities on the right-hand side, of the Balance Sheet. In England, the reverse order is followed, apparently to the great regret of some controversialists. But the student will be well advised not to be perturbed over this variation of practice, which is one more of tradition than of principle. In this country it is a frequent practice to term the left and right-hand sides of the Balance Sheet, respectively, the "Liabilities" (or "Capital and Liabilities") and the "Assets" sides, and, although these captions are frequently not strictly accurate, the student is recommended cheerfully to accept the fact. Neither need he worry unduly because another school may tell him that "Debtor" and "Creditor" are more precise captions for the two sides of the Balance Sheet, for, after all, "Sundry Creditors" appear on the debtor (Dr.) side, and "Sundry Debtors" on the Creditor (Cr.) side! No reasonable examiner will complain at either description.

It is an error common to many candidates to head the Balance Sheet, e.g. :—

The X.Y.Z. Co., Ltd. Balance Sheet for the year ended Dec. 31, 19...

This is inaccurate. A Balance Sheet sets forth the financial position as on a definite date, and does not cover a period as is the case with a Profit and Loss Account.

Marshalling Assets and Liabilities.—A reasonable and consistent method of marshalling assets and liabilities must be adopted, and the student will save time if he enters the examination room with an orderly method of so doing already fixed in his mind. Two methods are commonly employed :—

(*a*) Where the assets are ranged in the order of their permanence and unrealisability, and as far as possible the capital and relevant liabilities are ranged against them.

(*b*) Where the assets are placed in the order of their realisability, beginning with Cash in hand, and so on, and the liabilities are ranged in the order in which their payment can be demanded.

Method (*a*) is employed by the vast majority of commercial undertakings ; method (*b*) is adopted by, and is suitable for, banks and kindred institutions. The examination candidate should obtain equal marks for either method, provided that he intelligently applies the method selected. The *pro-forma* Balance Sheets on pp. 80–81 illustrate these methods.

Information Afforded by Balance Sheet.—The modern published Balance Sheet is not uncommonly distinguished by its paucity of detail. The plea that published accounts may afford trade rivals valuable information is somewhat overworked. There may be valid reasons for secretiveness in drafting the Profit and Loss Account, but shareholders are entitled to, and should be given, in the Balance Sheet, sufficient detail to enable them to form an intelligent estimate of the company's commitments, the nature and value of the assets, and the extent and adequacy of the reserves. The reticence of some companies regarding their financial position is chiefly manifested by the way in which they group assets dissimilar in kind, and allot one value to the whole group. An actual instance may be quoted, "*Freehold and Leasehold Land and Buildings, Machinery and Plant, Loose Tools, Furniture, etc., at cost less depreciation, £.......*" Such an agglomeration of mixed assets defies any attempt to estimate the true financial position of the company.

It would appear that such a description satisfies the *letter* of the Act of 1929, provided the goodwill, patents and trade-marks are shown separately, and the fixed assets so agglomerated are in fact valued on the basis stated, but, it is suggested, that such treatment does not satisfy the *spirit* of the act.

The Act provides that the Balance Sheet shall state such particulars as are necessary to disclose the general nature of the liabilities and the assets of the company, and to distinguish between the amounts respectively of the fixed assets and of the floating assets, and shall state how the values of the fixed assets have been arrived at.

The following entries, stating the method of valuation, would comply with the Act:—

(*a*) Freehold Land and Buildings, at cost ..		£ : :
(*b*) Leasehold Buildings, at cost less amounts written off		£ : :
(*c*) Leasehold Buildings at cost	£ : :	
Less Depreciation Fund	£ : :	
		£ : :
(*d*) Plant and Machinery, at cost..	£ : :	
Less Depreciation written off to date..	£ : :	
		£ : :
(*e*) Plant and Machinery at cost less depreciation		£ : :
(*f*) Plant and Machinery at cost less amounts written off to 1st January	£ : :	
Additions during Year	£ : :	
	£ : :	
Less Sales during year	£ : :	
	£ : :	
Less Depreciation for year	£ : :	
		£ : :

PRO-FORMA BALANCE SHEETS. METHOD A.

Blanks, Limited.

BALANCE SHEET, 31 DECEMBER, 19...

	£	s.	d.	£	s	d
Capital:—						
Authorised .. .. £						
Issued						
Less Calls in arrear						
Add Calls paid in advance						
Debentures						
Loans (secured by ....)						
Reserve Account						
Sundry Creditors:—						
Trade Accounts						
Bills Payable						
Outstanding Expenses						
Amounts due to Subsidiary Companies..						
Profit and Loss Account (balance)						
(NOTE.—Contingent Liabilities.)						
£						

	£	s.	d.	£	s.	d.
Goodwill, at cost						
Patents and Trade Marks, at cost						
Less amounts written off						
Freehold Land and Buildings, at cost						
Leasehold Land and Buildings, as at 1st January, 19.., at cost, *less* depreciation..						
Less Depreciation for year to date						
Machinery and Plant as at 1st January, 19. , at cost, *less* depreciation						
Less depreciation for year to date and loss on sale						
Add Additions during the year, *less* sales						
Loose Tools, as valued by the Works Manager						
Fixtures and Fittings as at 1st January, 19.., at cost, *less* depreciation						
Less depreciation for year to date						
Furniture as at 1st January, 19.., at cost, *less* depreciation						
Less depreciation for year to date						
Subsidiary Companies:—						
Shares at cost, *less* amounts written off						
Amounts due to this company						
Stock, as valued by the Managing Director						
Loans to Directors as at 1st January, 19..						
Advanced since..						
Less Repayments during year						
Loans to Employees to purchase shares						
Less Repayments during year						
Sundry Debtors						
Less Reserve for Doubtful Debts..						
Bills Receivable						
Unexpired Expenditure, Insurances, Deposits, etc. .. .						
Investments at cost or under						
(N.B.—The market value at the date of the Balance Sheet was £....)						
Cash: At Banks						
In Hand						
Preliminary Expenses, *less* amounts written off						
Discount on Debentures, *less* amounts written off						
£						

Notes.—The Balance Sheet of a private partnership would follow similar lines, except that the partners' Capital and Current Accounts are set out in detail as explained in Chapter VII.

If investments are held in respect of a Reserve Fund, they should be ear-marked for the service of the Fund.

METHOD B.

Steadfast Bank, Limited. BALANCE SHEET, 31 DECEMBER, 19...

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Capital:—							Cash in hand and with the Bank of England						
Authorised .. .. £							Balances with, and cheques in course of collection on, other Banks in the British Isles						
Issued							Money at Call and Short Notice						
Reserve Fund							Balances with Banks Abroad						
Profit and Loss Account (Balance)							Treasury Bills						
							British Bills of Exchange						
							Colonial and Foreign Bills						
Current, Deposit and other Accounts, including provision for Contingencies (Public and other Accounts secured as per contra are also included)							Investments at or under Market Value:—						
Balances in account with Subsidiary Companies							Treasury Bonds and other short-term British Government Securities						
Acceptances							Other British Government Securities (of which £.... nominal is lodged for Public and other Accounts) ..						
Endorsements Guarantees and other Obligations							Indian and Colonial Government Securities, and British Corporation Stocks						
							Other Investments (NOTE.—There is a Contingent Liability for uncalled capital in respect of a portion of these Investments)						
							Shares in Subsidiary Companies:—						
							London Bank Ltd., £... (nominal) Stock (£ ... paid up). Taken at Capital paid up, plus proportion of Reserve Fund and undivided Profits						
							Allysia Bank Ltd., ... shares of £.... each, fully paid, at £.... per share						
							Steadfast Foreign Banks Ltd., ... shares of £.... each, fully paid, at £.... per share						
							Loans and Advances						
							Balances in Account with Subsidiary Companies						
							Items in Transit						
							Other Assets and Accounts (including sundry Properties at cost, *less* amounts written off)						
							Bank Premises at cost, *less* amounts written off						
							Liabilities of Customers for Acceptances, as per contra ..						
							Liabilities of Customers for Endorsements, Guarantees and other Obligations, as per contra						
£							£						

(*g*) Plant and Machinery as valued by the Directors		£ : :
(*h*) Plant and Machinery at cost of installation	£ : :	
Less Depreciation Fund	£ : :	
		£ : :
(*i*) Plant and Machinery at cost	£ : :	
Less Reserve for Depreciation	£ : :	
		£ : :

It may be useful at this point to consider briefly the subject of assets and liabilities in general, and also in detail some particular assets and liabilities that commonly find a place in Balance Sheets.

ASSETS.

Assets Generally.—Assets may be divided into three classes: (*a*) Fixed Assets; (*b*) Floating Assets; (*c*) Assets of Unrealisable Value.

(*a*) *Fixed Assets.*—These are assets of a more or less permanent kind that are held not for sale, but solely in order to earn revenue. Of such are Land, Buildings, Machinery, etc.

(*b*) *Floating Assets* are those which have been made or acquired for sale and conversion into cash. Stock, Book Debts, Temporary Investments, etc., illustrate this kind of assets.

(*c*) *Assets of Unrealisable Value.*—To this category belong such assets as Preliminary Expenses, Debenture Issue Expenses, the debit balance of Profit and Loss Account, and the like. Such assets as these should be segregated at the end of the Balance Sheet, and any deductions that have been written off them during the year should be clearly shown.

Some writers seem fond of labelling assets as "tangible" or "intangible." An illustration of this now lies before the author. He is instructed that book debts is an example of a tangible asset, and goodwill of an intangible asset. But he remembers that he has some outstanding book debts which he wishes were tangible, and recalls an instance of a sale of goodwill for half a million sterling, which, in that instance, certainly could not have been very intangible! The examination candidate is advised not to be too free in his use of these labels.

In no case may Fixed and Floating Assets be combined in one item. Assets subject to waste should be separately stated, and the depreciation written off shown separately. Except under the double-account system, provisions made for waste should be deducted from the relative assets, and not stated as "Reserves" on the liability side of the Balance Sheet.

Loan debtors should be distinguished from trade debtors and Bills Receivable, and the provision made for bad debts should be clearly shown.

Any sums due from Directors or other officers of the company must be separately stated.

Investments should appear as a separate item, and the market value of the securities held at the date of the Balance Sheet be shown "short." If any "trade" investments, or investments in subsidiary companies have been made, they must be stated separately and not included with the ordinary Stock Exchange investments

Goodwill, if any, must also appear as a separate item, and be stated at cost, or at the book value, if the initial cost has been written down. Patents and Trade Marks may be aggregated with the Goodwill, but it is advisable to state them separately.

Stock in hand should be shown separately, and the basis of valuation stated.

Valuation of Assets.—It has already been stated that the values of the fixed assets in a Balance Sheet should be based upon their values to a going concern. These values are by no means always the same as their sale or current market values. The going concern values may be greater or less than the market values—the matter is of little moment. The fixed assets employed by a commercial undertaking are employed for profit-earning purposes, and the only practicable basis of valuation is cost less reasonable provision for waste and depreciation. Floating, or "quick" assets as Americans call them, should, on the other hand, be valued as nearly as possible at their actual present value to a going concern, which, in some cases at any rate, is their market price if less than cost. It will be obvious that the going concern basis of valuation adopted must be consistent year by year, otherwise the accuracy of the profits shown as having accrued since the previous Balance Sheet will be vitiated. The student will realise the supreme importance of the values placed upon the Assets in a Balance Sheet. If these values are not based upon reasonably accurate data, not only will the financial position of the undertaking be stated falsely, but the profits shown will be misleading—so intimate is the relation between capital and revenue.

Bankers and others, inspecting a Balance Sheet upon a request for a loan, will naturally review the assets rather upon a break-up basis than on that of a going concern.

Land and Buildings.—It is impossible to adopt hard-and-fast rules when valuing these assets. Freehold buildings may be slowly wasting owing to wear and tear; or depreciating in value because of growing obsolescence, whereas the land on which they stand may be steadily appreciating in value. Freehold land will probably fluctuate

in value, and the appreciation or depreciation may even be permanent. Unless there are cogent reasons against such a course, freehold land should be stated at cost; and the legal, surveyors', and other expenses of acquiring the land may legitimately be added to that cost, although it is more prudent, perhaps, to charge them to revenue over a term of years.

It cannot be affirmed that it is *ultra vires* to revalue an asset that has appreciated, and employ whatever increase in value may be thereby disclosed to decrease or eradicate an adverse balance standing at Profit and Loss Account. Directors who adopted this course were held to be justified in the absence of any fraudulent intent (*Ammonia Soda Co., Ltd.*, v. *Chamberlain and others*, [1918]). But, in the majority of cases, it is unwise to take credit for unrealised profits. Additions to freehold property may be capitalised at cost, provided always that the book value of any portion of the building demolished to permit of their erection is duly written off.

The cost of leasehold land, and the subsequent expenditure upon it, must be written off over the life of the lease. If there is an option for renewal, and it is desired to exercise the option, the best method, perhaps, of providing funds for the new lease is by means of an endowment policy of assurance.

Buildings stand in a different category from land. Freehold property, if kept in an efficient state of repair, need not be depreciated, but this cannot be laid down as an invariable rule. The original construction, present state, and other circumstances affecting the property must be taken into consideration.

Leasehold buildings must be treated as stated above in the matter of land. If the building is unlikely to last out the lease, that factor must also be taken into consideration.

From a mortgagee's or banker's point of view, the chief questions to be answered are: (1) Can the property be easily converted to other than its present use? (2) What is the site value? (3) Is the locality in which the building is situated waning or increasing in popularity?

Provision for wastage in connection with leases is most suitably made by the annuity method.

Frequently, a premium is paid for a lease. This premium represents commuted rent, and should be spread in equal instalments over the term of the lease. Money is frequently raised in these days of heavy death duties by the grant of leases at reduced rents in consideration of the payment of a cash premium. Such premiums represent rent paid in advance, and, similarly, should be spread over the term of the lease.

Dilapidations.—The liability to yield up demised premises in good repair at the end of a tenancy is usually attached to leasehold agreements. This is a contingent liability that must be provided for. The

extent of the liability should be carefully estimated by professional advisers, and a fund should be raised and invested, preferably outside the business, in order to meet it. Assurance policies are sometimes taken out for this purpose.

Cash at Bank.—This item should be the balance as shown by the Cash Book, and not that shown by the Pass Book, a certificate of which is obtained by the auditors from the Bank. But, of course, if the two balances differ a reconciliation statement should be prepared to prove the accuracy of the Cash Book balance.

Goodwill.—Several academic definitions of what is meant by goodwill are available, but none of them are entirely satisfactory. It is best, perhaps, to explain the term on the broad lines of practice, and to say that, in general, the purchaser of a goodwill acquires the right to represent himself as the successor to the business, and to enjoy every advantage attaching to the business, capable of transfer, that the former proprietor enjoyed. Thus the purchaser of goodwill acquires the trade name, trade marks, designs, patents, copyrights, etc., belonging to the business; he takes over the benefit of current contracts, agreements, leases, etc., and he acquires all the advantage accruing from the location, reputation, and organisation of the business. The actual concomitants of goodwill will vary with the particular business, but some, or all, of these elements will be present.

By its very nature, goodwill fluctuates in value, increasing as the profits of the business increase, decreasing as they fall. For sale purposes, the value of the goodwill is usually based upon a given number of years' purchase of the average annual profits, calculated over from three to five years of the most recent trading experience. The number of years' purchase varies, and depends upon the kind of business. From three to five years is a common basis of computation. It is becoming increasingly common to arrive at the value of goodwill on one of the following bases, which are more scientific than the rough-and-ready method already mentioned:—

Method (i): Assume that the value of the Net Assets (i.e. Assets *less* Liabilities) to be acquired is agreed at £180,000, and that the Average Profits available, before deducting the remuneration of the Partners or Directors (as the case may be), are £38,000. It is then necessary to ascertain the yield required on capital invested in the business, having regard to the risk involved, and thus to arrive at the return which the goodwill will yield. This can then be capitalised, e.g.:—

Average Profits	£38,000
Deduct: Remuneration of Partners or Directors, say	5,000
Profits available for interest on capital	33,000
Deduct: Interest at 15 % on the Capital paid for the net assets (i.e. say 5 % for pure interest and 10 % for risk)	27,000
Leaving available for return on investment in goodwill (i.e. "super-profits")	£6,000

The investment in goodwill will have to bring in the same yield as the investment in net assets, since the risk is the same, so that goodwill can be capitalised at £40,000 which is the amount of capital on which £6,000 of profits will return 15 %.

Method (*ii*): Assume the same facts as before:—

Average Profits	£38,000
Deduct : Remuneration	5,000
Leaving available as the reward for Capital	£33,000

If 15 % is the minimum return required on capital invested in that class of business, a profit of £33,000 capitalises at £220,000. The purchaser should, therefore, pay £220,000 for the net assets of £180,000, i.e. he pays for goodwill the sum of £40,000. The goodwill of a professional business, depending as such a business does upon the personality of the previous practitioner, will clearly be less than that attaching to a trading business in which the personal factor is of far less account. Again, goodwill based upon steadily increasing profits will be more marketable than goodwill based upon decreasing profits.

Goodwill rarely appears in a Balance Sheet unless it has been purchased. The duty of the Balance Sheet draftsman in this connection is to see that the asset is stated as a separate item at the amount at which it stands in the books, with the narration "at cost," or "at cost less amounts written off."

By S. 35 and Fourth Schedule, Part I (9), of the *Companies Act*, 1929, every prospectus issued by or on behalf of a company or of a person engaged or interested in its formation, and, by S. 40 and Fifth Schedule of the same Act, every statement in lieu of prospectus must state the amount paid for goodwill.

Unless the Articles direct that goodwill shall be written down, a limited company would appear to be under no legal obligation to reduce the cost price of this asset (*Wilmer* v. *McNamara*, [1895]).

The contention occasionally advanced that in all cases goodwill should be written down as a wasting asset, apparently on the ground that debts and death are the only certain things, is not very logical. The author has in mind a business well over a hundred years old and flourishing more vigorously than ever. On what basis should the goodwill of that business be estimated? Again, who can foretell the life of a goodwill, and who, therefore, can assess the instalments to be written off? It is suggested that changes in the value of goodwill cannot be treated on precisely similar lines to waste in connection with fixed assets, but must be dealt with in the light of actual circumstances. Goodwill may be written down as a means of retaining funds in the business, and so cheaply providing working capital, and where this course is desirable it is to be commended. But that is another matter.

The writing down of goodwill, where no permanent depreciation of the asset has occurred, is tantamount to the creation of a secret reserve, since in normal circumstances goodwill is constantly being renewed in the very fact that profits are maintained. In the author's view it is impracticable to attempt to record the fluctuating value of goodwill, and its reduction below the original cost price is a matter of financial prudence rather than one of obligation.

Goodwill, of course, is not a banker's security, and in scrutinising a Balance Sheet, preliminary to considering whether to grant an advance, the banker wisely ignores the asset.

Any provision made for the reduction of the asset goodwill is *an appropriation of profits* and not a charge against them.

The case of *Stapley* v. *Read Bros., Ltd.*, (1924), is of considerable interest to accountants in connection with the subject of goodwill. An injunction was sought to restrain the defendants (*a*) from distributing a dividend until the debit balance of the Profit and Loss Account had been discharged; (*b*) distributing as dividend profits originally applied to writing down the book value of assets and subsequently written back; (*c*) dealing with any unrealised profit resulting from an estimated appreciation in the value of capital assets.

Goodwill stood originally in the Balance Sheet at £140,000, and was subsequently written down by instalments out of profits to £51,000. A reserve of £61,000 was also created out of profits. Subsequently the balance of the goodwill was written off against this reserve, thus reducing the reserve to £10,000. By the year 1920, the reserve had been increased to £25,000, and a further £15,000 was transferred thereto from the balance of the current Profit and Loss Account (£33,000), making the balance £40,000. This balance of £40,000 was then distributed in the form of fully paid shares by way of a capital bonus.

But a period of bad trade was experienced, and at the close of the year 1922 there was a debit balance on Profit and Loss Account of £20,504 16s. 6d. A profit of £1,300 was made in the year 1923, but three years' preference dividends were in arrear. The directors proposed (*a*) to pay the arrears of preference dividend out of current profits; (*b*) write back to reserve £40,000 of the amount written off goodwill; and (*c*) eliminate the debit balance (£20,505) of Profit and Loss Account.

The plaintiff did not contend that the goodwill was not worth at least £40,000, but that profits utilised to write down the book values of assets could not afterwards be written back, and be treated as available for distribution. Mr. Justice Russell said that in his view " the sole question was whether the Profit and Loss Account is to be treated as a continuous account so that no dividend could be declared out of one year's profits until any debit to Profit and Loss in respect of prior years had been made good." In his opinion it was not so to be treated.

If £40,000 had been carried to reserve from profits it could have been subsequently distributed as dividend. Did it make any difference if the company, instead of carrying that sum to reserve, utilised it to write down the value of goodwill? Had the company permanently capitalised those profits so as to disentitle it to restore them to reserve? The shareholders had approved the directors' previous reports and proposals, but they had not bound themselves to give up their claims to the profits that had been carried to reserve and employed to eliminate goodwill. In brief, those profits had not been permanently capitalised. The injunction applied for was refused.

Machinery and Plant.—The various methods employed to meet waste in connection with this asset have been discussed (see pp. 42–9). Whichever method is adopted, the result to be ensured is that the asset shall be stated in the Balance Sheet not at its market value but at a figure that represents its unexpired capital value to a going concern, i.e. "at cost" (if new), or at cost less depreciation, showing the "Balance of cost over depreciation as per last Balance Sheet," and the net value of the asset, after deducting depreciation for the year. Occasionally, one finds that this asset is stated at its original cost, and on the liabilities side of the Balance Sheet there appears a Depreciation Fund, representing the accumulated provision made for depreciation to date. This method cannot be recommended. It is better to show the value of the asset *net* on the assets side. Its present book value can then be seen at a glance. See also p. 79 as to other methods of stating this asset.

Where the plant is extensive and of various kinds, a Memorandum Plant Ledger, or Register in the form shown on p. 89, should be kept. Such a record is of great value as a check upon the provision made for waste, and is also useful when making claims for allowances in this connection in respect of Income Tax.

In reviewing a Balance Sheet, the loan creditor will eliminate plant which is "fixed" to the building if the premises are mortgaged. He will also heavily depreciate any machinery which is special to the trade carried on, and will ignore assets partly paid for under the hire-purchase system.

Loose Tools, etc.—Depreciation of this asset by ordinary methods is impracticable. Many of the tools may be made by the firm's own workmen, and constant additions, losses, scrapping, and "borrowing" will vary the quantity of the stock held. Actual valuation is the only safe method to adopt. The value of horses, lorries, carts, live stock, moulds, and similar assets should also be ascertained by periodical valuation. In all these cases, fixed percentage depreciation is often misleading.

Trade Marks, Patterns, Dies, Drawings, etc.—It is difficult to deal with these except on the basis of cost, subject to periodical survey, in order to prevent obsolete trade marks, patterns, etc., being included.

PLANT LEDGER.

Particulars of Machine: *Automatic Drill.*
Erected in: *Machine Shop.*

Date Purchased: *December 31, 19...*
Expected Life: *Ten Years.*

Makers: *Hard, Steel & Co.*
Residual Value Estimated at: *£200*

Date.	Particulars.	Folio.	Original Cost and Additions.	Repairs.	Renewals.	19...		19...		19...	
						Depreciation written off.	Book Value.	Depreciation written off.	Book Value.	Depreciation written off.	Book Value.
			£ s. d.	£ s. d.	£ s d.	£ s. d.	£ s. d.	£ s. d	£ s. d.	£ s d.	£ s. d.
19 .. *Dec. 31*	*Cost of Machine purchased from Porter & Co. at this date..*		*5,000 0 0*			*480 0 0*	*4,520 0 0*				
19... *Dec. 31*	*Additions during the year .. .. ..*		*100 0 0*								

NOTE.—The Repairs column is employed as a record of the expenses incurred in connection with each machine. As this expense is charged to Revenue it does not, of course, form part of the book value.

(Investment Ledger.)

ARCADIA 5 % GOLD BONDS.

Numbers of Bonds .... Interest payable June 1st and December 1st.

Dr. Cr.

Date.	Details.		Nominal. £ s. d.	Interest. £ s. d.	Principal. £ s. d.	Date.	Details.		Nominal. £ s. d.	Interest. £ s. d.	Principal. £ s. d.
19... Dec. 1	To Cash: 10 Bonds of £100 each at par, and expenses		1,000 0 0		1,005 0 0	19... June 1	By Cash: Half-year's interest £25 0 0, *Less* Tax at 4s. 5 0 0			20 0 0	
June 30	,, Profit and Loss (Interest) Account			20 0 0		,, 5	,, Cash: Sale of 5 Bonds at £110, *less* expenses ..		500 0 0		548 0 0
,, 30	,, Profit on Sale of Investments Account ..				45 10 0	,, 30	,, Balance carried down at cost		500 0 0		502 10 0
		£	1,000 0 0	20 0 0	1,050 10 0			£	1,000 0 0	20 0 0	1,050 10 0
19... June 30	To Balance brought down		500 0 0		502 10 0						

Trade Marks can be grouped with goodwill and patents in the Balance Sheet (see p. 83).

Patents.—The protection afforded by a patent lasts for sixteen years from its date. But the life of a patent may be extended by order of the High Court, on petition by the patentee, where sufficient cause for extension is shown. The original cost of the patent, if purchased, together with all fees paid in respect thereof should be written off over the life of the patent or earlier. Similarly, all expenses and the costs of experiments in connection with the invention patented should also be written off within its life. This is the broad theory, but it may have to be modified to fit the circumstances, e.g. in the event of the complete failure of the patent.

Copyrights.—These extend for fifty years after the author's decease. It is difficult to value this sort of property, since the value of a copyright may last long or quickly wane. Periodical survey and valuation is the only safe method.

Furniture, Fixtures, and Fittings.—Office furniture may last a long time, and possess considerable second-hand value. But Fixtures and Fittings should be much more heavily depreciated than Office Furni-

ture, since these are usually worth little more than firewood when it comes to alteration of premises, removal, or sale. Particularly is this the case if they are specialised to the trade. If the premises are leasehold some of the fittings will become the property of the landlord at the expiration of the lease, and particular care is needed in such cases to eliminate the asset from the books during the life of the lease.

Investments.—Investments cannot be said to depreciate in the ordinary sense, that is owing to wear and tear, but they may fluctuate in capital value. If investments are fixed assets held for the purpose of producing revenue, fluctuations in value may be ignored, provided that they are not permanent. The basis of valuation, cost or market price, should be stated, and, where the value is stated at cost, a note should appear on the Balance Sheet of their aggregate market value. Special reserves are often created to meet actual or possible fluctuations in the value of investments, especially when the investments held are heavy. Investments which represent a reserve fund should be separately stated in the Balance Sheet. If these investments are less in amount than the reserve, it indicates that the balance of the fund is comprised in the general assets of the business. Trade investments, i.e. shares held for trade purposes, or shares in associated companies, should also be separately stated. If any liability for uncalled capital attaches to investments, a note of the fact should be made in the Balance Sheet.

A separate ledger should be kept to record investment holdings, and a separate account for each investment, ruled as shown on p. 90.

Some companies (e.g. Assurance Companies) are under statutory obligation to marshal their investments in the Balance Sheet under specific headings. Apart from such obligation, the usual practice is to insert investments under the one heading, but where investments are held in subsidiary companies they must be stated separately as such, although only the aggregate need be stated, i.e. it is not necessary to show the holding in each subsidiary company.

Interest Accrued Due.—Interest on debentures, mortgages, and similar fixed interest investments is frequently apportioned, and the amount applicable to the period covered by the accounts is taken credit for in the Profit and Loss Account, a like amount being scheduled as an asset in the Balance Sheet. There is no objection to this procedure, but the practice sometimes met with of including an *estimate* of dividends accruing on *ordinary* shares is not to be commended, based as it must be upon mere guesswork.

Mines, Quarries, etc.—It is not the usual practice in this country to provide for the wastage of this kind of property consequent upon the gradual exhaustion of the mineral or other contents; and mining and similar companies are under no legal obligation to keep their capital intact. "If a company is formed to acquire or work property of a wasting nature, e.g. a mine, quarry, or a patent, the capital expended

in acquiring the property may be regarded as sunk and gone" (Lindley, L.J., in *Lee* v. *Neuchatel Asphalte Co., Ltd.*, [1889]). No deductions for waste in respect of such property are allowed for income tax purposes. If it is desired to make provision for waste, the yearly amount to be set aside should be based upon (*a*) the price paid for the mine and its estimated total contents; (*b*) the quantity of the product extracted during the current period; and (*c*) the estimated residual value of the land. The estimated cost value of the tonnage raised during the year gives the amount of the provision to be made.

Stock-in-Trade.—It has already been stated that the basis of valuation must be consistent period with period. There is a classic accounting rule that stock should be valued at cost or at market price, whichever is the lower. But this axiom needs qualification. If the fall in market value is temporary only, there is no need to reduce the book value of stock held by a going concern. In many cases "cost" may legitimately include freight, duty, and carriage. Deterioration due to damage, change of fashion, and similar causes must be allowed for. In short, only permanent diminution in value need be recognised. But profits must not be anticipated by the over-valuation of stock. Goods out on approval, and stock in transit to agents, must be valued on the same basis as stock in warehouse, and not be treated as sales.

Large differences between opening and closing stocks, or those of previous trading periods, should be investigated. Such variations may be due to (*a*) inaccurate stocktaking; (*b*) alteration in the basis of valuation; (*c*) overstocking; (*d*) changes in the prices of raw materials; (*e*) sales failing to keep pace with manufacture; (*f*) faulty buying. Whatever the cause it should be traced. Allowing for fluctuations in turnover, there should be reasonably close correspondence between opening and closing stocks for different periods, and if there is not an explanation is called for.

The Balance Sheet should state by whom the stock has been valued, e.g. thus: *Stock at December 31st*, 19.., £— —s. —d. (*as valued by Departmental Managers*).

Work in Progress.—The basis upon which this asset should be valued and the shortcomings of examination candidates when dealing with such items have been dealt with on p. 24.

Sundry Debtors.—The balances of the Sales Ledgers should be extracted on separate sheets, the total of which is carried into the main Trial Balance. There will probably be some small credit balances arising from over-payment, unclaimed allowances, etc. These, strictly speaking, should be added to the total balance of the Sundry Creditors. In some instances, provision is made for doubtful debts by assessing each account where provision is necessary, but it is the more usual practice to reserve a fixed percentage on the total debtors. A reasonably constant ratio between sundry debtors and turnover

should exist, allowing for the usual run of trade credit. Care must be taken that all trade discounts and returns have been dealt with; and trade and other loans should be stated in the Balance Sheet separately from ordinary trade debtors. Advances to and amounts due from subsidiary companies must be stated as a separate total.

The amount of any loans made during the period of the Profit and Loss Account, either by the company or by any other person under a guarantee from or on a security provided by the company to any director or officer of the company, including any loans repaid during the period; also any such loans made previously and still outstanding, must be shown on the Balance Sheet or on the Profit and Loss Account, unless it is part of the ordinary business of the company to lend money, and the loan was in the ordinary course of business (e.g. a bank) or the loan was one not exceeding £2,000 to any employee of the company and is certified by the directors to have been made in accordance with the company's practice with respect to loans to its employees. There must be stated separately on the Balance Sheet the outstanding amount of any loan made for the purchase by trustees of fully-paid shares in the company to be held by or for the benefit of employees, or made to employees other than directors with a view to enabling them to purchase fully-paid shares in the company to be held by themselves by way of beneficial ownership.

In addition to provision for doubtful debts, a reserve should be created in connection with foreign debtors against possible losses due to fluctuations in exchange. It has already been stated that, in the majority of cases, no reserve for discount is deducted from the book debts. The loan creditor must, however, remember that if forced realisation supervenes, the asset will be reduced by such discounts as are claimable.

Development Expenditure.—Companies working mines, collieries, plantations, and similar property are frequently obliged to consume considerable time and capital in order to bring the property to the revenue-earning stage. During the work of development, practically all expenditure on development is capitalised. The sinking of shafts and driving of adits and levels; pumping, tree-planting, and road-making afford examples of development expenditure. There can be no objection to treating such expenditure as an asset, provided that, when the venture reaches the revenue-earning stage, steps are taken to write off the expenditure within a definite period of time. The accountant will probably need expert assistance before he can accurately adjust such expenditure as between capital and revenue.

In a case where a public utility company constructed works by the aid of its own employees it was allowed to add to its capital expenditure on actual constructional work, the interest and dividends paid on loans and preference shares raised to pay for the construction (*Bardwell* v. *Sheffield Waterworks Co.*). Interest during construction can also be

paid under the conditions laid down in *The Companies Act*, 1929, S. 54, and *The Companies (Interest out of Capital) Order*, 1929 (see p. 416).

Deferred Revenue Expenditure.—Expenditure such as Preliminary Expenses, Share and Debenture Issue Expenses, Debenture Discount, Removal Expenses, Repairs (if abnormally heavy), and the like must be carefully reviewed, and, as explained before, may be "held up" as an asset legitimately, if written off over a reasonable period. It is assumed in such cases that benefits will accrue in succeeding years from the expenditure, and so these years should bear their proportion of the burden. It has already been explained that suspense expenditure such as Insurance, Rent, Rates, and Advertising paid in advance may be apportioned over the period they cover. All assets of this kind are, of course, worthless from the creditor's or banker's point of view. Certain of the items must be shown separately (see pp. 497 *et seq.*).

Liabilities.

Liabilities Generally.—As we have seen, the values placed upon assets are necessarily to some extent based upon personal opinion. But liabilities, except contingent liabilities, are capable of exact statement.

To a certain extent, liabilities may be classified as "fixed" or "floating." Thus, debentures and loans that are not payable on demand, but at some definite distant date, may be said to be "fixed," while current trading debts, due for payment in the immediate future, may be regarded as "floating." Care should be taken that these two classes of liability are separately stated in the Balance Sheet. Unless this is done it is impossible for the critic of a Balance Sheet to judge whether the "floating" assets are adequate to meet the "floating" liabilities, and to provide sufficient working capital. Where any liability of a company is secured otherwise than by operation of law on any assets of the company, the Balance Sheet must include a statement that the liability is so secured, but it is not necessary to specify on which assets the liability is secured.

Capital.—It is usual to head the liabilities with a statement of the capital, although, in theory, outside liabilities should first be dealt with, since the capital item is the balance or net worth of the proprietor of the business. The statement of capital in the Balance Sheet of a partnership has been dealt with in Chapter VII.

The nominal, subscribed, and paid-up capital of a limited company must be clearly stated in order that the uncalled capital, if any, may be seen. If redeemable preference shares are outstanding, they must be stated separately with a note as to the date on or before which they are, or are to be liable, to be redeemed. Calls paid in advance, unpaid calls, and any shares that have been forfeited, together with the amounts paid up on them, must be separately stated. Shares which have been

issued as fully paid in whole or part consideration for assets acquired should be separately stated, e.g. "50,000 *ordinary shares of £1 each issued as fully paid to Vendors as purchase price of the Goodwill.*" If any shares have been issued at a discount under the Act of 1929, so much of the discount as has not been written off must be separately stated on the assets side of the Balance Sheet.

If capital has been issued under S. 54 of the Act of 1929 the Accounts must disclose the share capital on which and the rate at which interest has been paid out of capital during the period (see p. 417).

Debentures.—These must be stated separately, so also must any interest accrued upon them; and if the debentures have been issued at a premium, the premium must also be separately stated. If the debentures have been issued at a discount, the discount, less any amount written off, will appear on the Assets side of the Balance Sheet. Debentures issued as collateral security for a bank loan are frequently incorrectly treated by examinees. The only entry necessary in this connection is as follows :—

Loan from Bankers (secured by the issue of £24,000 5 % Mortgage Debentures) £20,000 0 0

The debentures are not extended in the outer column as a liability; they are a contingent liability, and can be enforced only if the interest on the loan is in arrear. When the debt is repaid, the debentures are released.

The usual method of stating capital and debentures in a company Balance Sheet is as follows :—

		£	s.	d.	£	s.	d.
Capital :—							
Nominal—							
100,000 5 % Preference Shares of £1 each		100,000	0	0			
150,000 Ordinary Shares of £1 each		150,000	0	0			
£		250,000	0	0			
Issued—							
100,000 5 % Preference Shares of £1 each, fully paid		100,000	0	0			
100,000 Ordinary Shares of £1 each, 10s. per share called up	£50,000						
Less Calls in arrear ..	500						
	49,500						
Add Calls paid in advance	500	50,000	0	0	150,000	0	0
Debentures :—							
500 5 % Debentures of £100 each					50,000	0	0
Premium on Shares Account					2,500	0	0

Where a company has power to reissue debentures which have been redeemed, particulars with respect to the debentures which can be so re-issued must be included in the Balance Sheet, e.g.:—

	£	£
1,000 6 % *Debentures of £50 each*	50,000	
Less: 200 Debentures which have been redeemed and are available for reissue	10,000	
		40,000

Capital Redemption Reserve Fund.—If Redeemable Preference Shares have been redeemed out of profits, an amount equal to the profits so used must be set aside to a Capital Redemption Reserve Fund which must appear separately on the Balance Sheet.

Mortgages.—Amounts due to mortgagees are sometimes stated on the liabilities side of the Balance Sheet; preferably, however, they should be deducted from the asset on the security of which the mortgage was made.

Sundry Creditors.—The Trade Creditors should not be combined with other debts Loans, bank overdrafts, and other cash debts should be separately stated, so also should Bills Payable. The credit terms customary in the trade will afford an indication as to whether the liabilities are abnormally heavy. If any securities or charges are held by creditors, the fact must be noted. Amounts due to subsidiary companies must be shown as a separate total.

Accrued Liabilities, such as wages, salaries, directors' fees, rent, and the like, should be separately stated after the trade debts.

Contingent Liabilities.—These undetermined liabilities should be indicated in the Balance Sheet in the form of notes.

Maintenance Fund.—A reserve under this heading appears sometimes on the liabilities side of a Balance Sheet. The method of creating and operating funds of this nature has been explained on p. 58.

Reserves.—These have already been dealt with. They should be stated separately, and the reason for their creation be indicated, if they have been made for a specific purpose, e.g. to provide for a known contingency; or for the equalisation of dividends, etc.

In America the term "surplus" is commonly used instead of the word "reserve." The Bank of England employs the term "Rest." The balance of profit is carried to this account, and the stockholders' dividends are debited thereto, the balance standing to the credit of the Rest never being allowed to fall below £3,000,000. The student cannot, however, be advised to adopt the somewhat archaic methods still followed by the Bank.

Preparation of Accounts in Examination Work.

Book-keeping examination papers almost invariably contain a long "working question," which requires the preparation of a Trading (Manufacturing) Account, a Profit and Loss Account, and a Balance

Sheet. The answering of this question takes up a large proportion of the time allotted for working the paper as a whole, and naturally carries a high percentage of the total marks attainable. Indeed, in the majority of examinations, a "pass" cannot be secured unless this question is well answered. In the author's experience, many candidates come to grief over this question, either (*a*) because they fail to devote sufficient time to it, or (*b*) because they attack it without method, and therefore without safeguards against error.

As a general rule, a question of this kind begins with a preamble detailing particulars regarding such matters as the issue of capital and debentures, forfeited shares, unpaid calls, and the like. Then follows a schedule of balances, and, at the end, a list of adjustments, or "instructions," to be taken into consideration when preparing the accounts.

Now, many candidates attempt to prepare the accounts *direct* from the examination paper, i.e. they do not previously draw up a Trial Balance from the information supplied. In that way, they handicap themselves, for long examination experience proves that the time spent in constructing a Trial Balance, and journalising the adjustments to be made, is an economy in the end, and a safeguard, since it is quite common to find that an examinee will record one aspect of an adjustment or instruction correctly, but allow the other aspect to escape his memory. Moreover, although the preparation of a Trial Balance is not usually demanded by the terms of this kind of question, its inclusion with the rest of the workings frequently saves the examiner's time.

By way of practical illustration, consider the following typical examination question :—

Rindges, Ltd., was registered with a nominal capital of 300,000 shares of £1 each. 200,000 shares were issued at a premium of 2s. 6d. per share, and were fully subscribed, and 12s. 6d. per share, including the premium, was duly paid up, with the exception of a call of 2s. 6d. per share on 4,000 shares which remained unpaid.

In addition to the above, the following balances were extracted from the books as on March 31, 19.. :—

Plant and Machinery, £32,000; Manufacturing Wages, £36,842; Machinery Repairs, £1,286; Freehold Factory, £62,580; Repairs to Factory Buildings, £794; Rates (Factory, £942; Office, £120), £1,062; Fire Insurances (Factory, £920; Office, £64), £984; Employers' Liability Insurance, £1,262; Directors' Fees, £1,000; Discount Account (Credit Balance), £214; Office Furniture, £900; Transfer Fees, £62; Apprentices' Premiums, £600; Carriage (Inwards, £842; Outwards, £1,342), £2,184; Preliminary Expenses (Balance), £780; Office Expenses, £1,321; Office Salaries, £5,228; Cash in hand, £1,258; Power and Light (Factory), £995; Gas and Electricity (Office), £72; Cash at Bank, £12,641; Profit and Loss Account (Credit Balance from last year), £6,484; Goodwill, £25,000; Stock at beginning of year (Raw Materials, £6,280; Work in Progress, £1,250; Finished Goods, £4,861), £12,391; Interim Dividend paid July 1, 19.., £5,000; Loose Tools (at beginning of year), £2,960; Purchases (Net),

£39,462; Sales (Net), £123,872; Sundry Debtors, £36,842; Sundry Creditors, £29,112.

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended March 31, 19.., and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into consideration:—(*a*) Stock was valued, as on March 31st, as follows: Raw Materials, £4,401; Finished Goods, £3,721; Work in Progress, £2,528. (*b*) Loose Tools were valued at £2,200. (*c*) The five apprentices, from whom £600 in fees had been received, had served only one of the three years of their indentures. (*d*) 10 % depreciation is to be written off Machinery and Plant, and 5 % off Office Furniture. (*e*) The balance of the Preliminary Expenses Account is to be written off. (*f*) Reserve £500 for discount on Sundry Debtors' Accounts, and £1,000 for Bad and Doubtful Debts. (*g*) The following had accrued due, as on March 31st: Wages, £360; Salaries, £220; Directors' Fees, £250.

As is usual with this type of question, the preamble contains details of transactions that form a necessary part of the Trial Balance. The first step, therefore, is to start the schedule of balances with these particulars as follows:—

	£	s.	d.
Share Capital: 200,000 shares of £1 each, 10s. called up	100,000	0	0
Premium on above, 2s. 6d. per share	25,000	0	0
Calls in arrear, 2s. 6d. per share on 4,000 shares	500	0	0
The next step is to add the schedule of balances that appear in the question. The total of these amounts to	445,188	0	0
£	570,688	0	0
One-half of this total must, of course, represent the totals both of the debit and the credit balances .. .. £	285,344	0	0
The analysis of the balances as between debits and credits is the next step; and this is quickly effected by first selecting the credit balances, since these are always few in number and readily recognisable. They are as follows:—			
Share Capital	100,000	0	0
Premiums Account	25,000	0	0
Discount (Credit Balance)	214	0	0
Transfer Fees	62	0	0
Apprentices' Premiums	600	0	0
Profit and Loss Account (Credit Balance from last year) ..	6,484	0	0
Sales	123,872	0	0
Sundry Creditors	29,112	0	0
£	285,344	0	0

The remaining balances must perforce be debits. By this process, therefore, we obtain an accurate Trial Balance.

The remaining loopholes for error reside in the adjustments or instructions. The wise examinee will, therefore, draft journal entries setting forth these adjustments, somewhat as follows:—

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		Dr. £	s.	d.	Cr. £	s.	d.
Stock Account (B/S) .. .. Dr.		10,650	0	0			
To Manufacturing Account					10,650	0	0
(Final Stock.)							
Depreciation (Profit and Loss Account) .. .. Dr.		4,005	0	0			
To Machinery and Plant Account (B/S)					3,200	0	0
,, Office Furniture (B/S)					45	0	0
,, Loose Tools (B/S)					760	0	0
(Depreciation written off)							
Apprentices' Fees (*Manufacturing Account*) .. Dr.		400	0	0			
To Sundry Creditors (B/S)					400	0	0
(Fees carried forward.)							
Profit and Loss Account .. .. Dr.		780	0	0			
To Preliminary Expenses (B/S)					780	0	0
(Balance written off.)							
Reserves (Profit and Loss Account).. .. .. Dr.		1,500	0	0			
To Sundry Debtors (B/S)					1,500	0	0
(Discounts and Bad Debts.)							
Sundries Dr.							
Manufacturing Wages (Manufacturing Account)		360	0	0			
Salaries (Profit and Loss Account)		220	0	0			
Directors' Fees (Profit and Loss Account)		250	0	0			
To Sundry Creditors (B/S)					830	0	0
(Amounts outstanding)							

If the question contains information which cannot be noted in the form of a journal entry, e.g. the existence of a contingent liability in respect of uncalled capital, investments held, bills discounted, etc., the examinee should make sure of dealing with the point or points by marking his question paper in the margin as follows : "*Note Contingent Liability(ies) in Balance Sheet.*"

The Trial Balance and the journalised adjustments having been drafted as above, a sure foundation is laid for the preparation of the accounts required by the question, and, in the absence of gross carelessness, these precautions will ensure accounts that "balance." Failure to achieve this much-desired result appears to throw the inexperienced student into a state of panic, which lack of system in searching for the error does nothing to relieve.

As a first step, the items in the Trial Balance and the journal adjustments should be checked into the accounts. If this fails to locate the error, other tests can be applied. If the difference is a round sum, e.g. £10 or £100, it probably points to an error in arithmetic, e.g. in the additions of totals, or in the deductions of depreciations, reserves, etc. ; or it may result from a carelessly placed figure, e.g. the figure 1, that has been reckoned in the wrong column, thus making a difference of 9, 90, 900 as the case may be. If the error is an uneven amount, it probably results from an omission, or from entering an amount twice over, in which case an item in the Trial Balance of the exact amount of the error should be sought. Another frequent error occurring in the hurry of examination work is the placing of an entry on the wrong

side of the account, and then search for an amount half that of the "difference" should reveal the error.

Other common errors include (1) Omitting to bring down the gross profit into the Profit and Loss Account; (2) Entering the *opening*, instead of the *closing*, stock figure in the Balance Sheet; (3) Calculating Reserve for Discount on Sundry Debtors *before* deducting the Bad Debt Reserve, whereas discount should only be reserved on the *good* debts; (4) Where depreciation appears in the Trial Balance, it has *already* been deducted from the asset, if, therefore, it is desired to show the deduction in the Balance Sheet, the balance of the asset account, as given in the Trial Balance, must first be increased by the amount of the depreciation written off; (5) Some examinees appear to be so accustomed to exercises which result in a *profit*, that when they encounter an examination question resulting in a *loss*, they mechanically enter the debit balance of the Profit and Loss Account on the liabilities side of the Balance Sheet! Many failures result from this careless error.

The Accounts in their final form will appear as on pages 101, 102 and 103.

EXAMINATION QUESTIONS.

1. State points of difference between a Trial Balance and a Balance Sheet. (*Chartered Secretaries.*)

2. Is there any difference between a Balance Sheet and a Statement of Affairs? Submit a *pro-forma* example of the latter. (*Royal Society Arts.*)

3. Express fully your opinion upon the methods of grouping items under general headings in a Balance Sheet, and state what distinction you would make between realisable Assets and Debit Balances of a suspense nature. Give examples. (*Chartered Accountants.*)

4. State the principle upon which you would marshal the Assets and Liabilities in the Balance Sheet of a limited company, giving reasons for the basis you adopt. (*Royal Society Arts.*)

5. Submit the credit side of a *pro-forma* Balance Sheet of a limited company. Divide the assets you select into "fixed" and "floating," and describe the difference, if any, in the obligation to provide for depreciation, or waste, in connection with the two classes of assets. (*Royal Society Arts.*)

6. What do you understand by the phrase "the working capital of a company"? Set out with imaginary figures how it could be shown in accounts published for the information of shareholders. (*Incorporated Accountants.*)

7. Give the full and proper manner of stating and marshalling the following assets in the Balance Sheet of a limited company: Goodwill; Investments; Stock; Leasehold Premises; Fittings, Fixtures and Furniture; Sundry Debtors; The B/L or D/O for part of the stock held by the Bank by way of security.

There is an uncalled liability on investments. (*Incorporated Accountants.*)

8. What evidence would you call for to establish the existence of the following assets included in a firm's Balance Sheet: (*a*) Land and Buildings; (*b*) Investments (including Registered War Loan); (*c*) Plant and Machinery; (*d*) Work in Progress.

What steps would you take to verify the values put on these assets? (*London Association Accountants.*)

Messrs. Rindges, Limited.

DR. MANUFACTURING ACCOUNT FOR THE YEAR ENDED MARCH 31, 19.. CR.

	£	s.	d.	£	s.	d.
To Stock—						
Raw Materials ..	6,280	0	0			
Work in Progress	1,250	0	0			
Finished Goods ..	4,861	0	0	12,391	0	0
,, Purchases				39,462	0	0
,, Wages				37,202	0	0
,, Repairs (Machinery)				1,286	0	0
,, Repairs (Buildings)				794	0	0
,, Rates				942	0	0
,, Fire Insurance				920	0	0
,, Employers' Liability Insurance				1,262	0	0
,, Carriage				842	0	0
,, Power and Light				995	0	0
,, Balance carried to Profit & Loss Account				38,626	0	0
			£	134,722	0	0

	£	s.	d.	£	s.	d.
By Sales				123,872	0	0
,, Apprentices' Premiums				200	0	0
,, Stock—						
Raw Materials ..	4,401	0	0			
Work in Progress	2,528	0	0			
Finished Goods	3,721	0	0	10,650	0	0
			£	134,722	0	0

Messrs. Rindges, Limited.

Dr. PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED MARCH 31, 19... Cr.

	£	s.	d.		£	s.	d.
To Rates	120	0	0	By Balance from Manufacturing Account	38,626	0	0
,, Fire Insurance	64	0	0	,, Discount Account	214	0	0
,, Directors' Fees	1,250	0	0	,, Transfer Fees	62	0	0
,, Carriage Outwards	1,342	0	0				
,, Preliminary Expenses	780	0	0				
,, Office Expenses	1,321	0	0				
,, Office Salaries	5,448	0	0				
,, Gas and Electricity	72	0	0				
,, Depreciation— £ s. d.							
Plant, 10 % 3,200 0 0							
Furniture, 5 % 45 0 0							
Loose Tools (valuation) 760 0 0	4,005	0	0				
,, Reserve for Discount on Debtors	500	0	0				
,, Reserve for Bad and Doubtful Debts	1,000	0	0				
,, Balance carried down	23,000	0	0				
£	38,902	0	0	£	38,902	0	0
To Balance carried down	24,484	0	0	By Balance brought down	23,000	0	0
				,, Balance from last year £6,484 0 0			
				Less Interim Dividend paid 5,000 0 0	1,484	0	0
£	24,484	0	0	£	24,484	0	0
				By Balance brought down	£24,484	0	0

Messrs. Rindges, Limited.

BALANCE SHEET, MARCH 31, 19...

			£	s.	d.
Capital:—					
Nominal:					
300,000 Shares of £1 each	£300,000 0 0				
Issued:					
200,000 Shares of £1 each:					
10s. per share called up	£100,000 0 0				
Less Calls in arrear	500 0 0		99,500	0	0
Premium on Shares			25,000	0	0
Sundry Creditors	£29,112 0 0				
Apprentices' Premiums	400 0 0				
Wages, £360; Salaries, £220; Directors' Fees, £250	830 0 0		30,342	0	0
Profit and Loss Account (Balance)			24,484	0	0
		£	179,326	0	0

				£	s.	d.
Goodwill at cost				25,000	0	0
Freehold Factory at cost				62,580	0	0
Machinery and Plant at cost, *less* depreciation previously written off		£32,000 0 0				
Less Depreciation for year		3,200 0 0		28,800	0	0
Office Furniture at cost *less* depreciation previously written off		£900 0 0				
Less Depreciation for year		45 0 0		855	0	0
Loose Tools at cost, *less* depreciation previously written off		£2,960 0 0				
Les Depreciation for year		760 0 0		2,200	0	0
Stock:						
Raw Materials		£4,401 0 0				
Finished Goods		3,721 0 0				
Work in progress		2,528 0 0		10,650	0	0
Sundry Debtors		£36,842 0 0				
Less Reserves:						
Discounts	£500 0 0					
Bad and Doubtful Debts	1,000 0 0					
		1,500 0 0		35,342	0	0
Cash at Bank		£12,641 0 0				
Cash in hand		1,258 0 0		13,899	0	0
			£	179,326	0	0

9. You have been instructed by a client to report upon the Balance Sheet of X. Y., a customer, to whom he has been asked to give extended credit.

Describe the detailed enquiries you would make, before submitting your report, regarding the following items which appear as assets in the Balance Sheet: Freehold and Leasehold Works, £38,642; Patents and Trade Marks, £10,000; Machinery and Plant, £15,968; Lease and Stock (Foreign Branch), £3,472; Loose Tools, £1,576; Extraordinary Expenditure (Advertising carried forward), £5,000. (*Chartered Accountants.*)

10. Define: "Contingent Liability," "Collateral Security," and state how you would treat them in the Final Accounts of a firm. (*Incorporated Accountants.*)

11. "Sundry Creditors, including credit balances," is an item sometimes seen in accounts. What in your view are the dangers of such an item, and in what respect could it be used for wrong purposes? (*Incorporated Accountants.*)

12. When preparing a Balance Sheet, upon what principle should outstanding consignments be valued? (*Chartered Accountants.*)

13. How would you deal with the following items when closing the books and preparing the accounts of a limited company: (*a*) 150 Ordinary Shares of £1 each upon which 5s. per share has been paid, the shares being subsequently forfeited by the Directors. (*b*) £5,000 Arcadian Government 5% Stock, representing the investment of part of the Reserve Fund, purchased at 101 and now quoted at 95. (*c*) The Stock and Fixtures at the company's Exeter leasehold warehouse were valued, as at the close of the company's financial year, at £3,246 and £500 respectively. A few days later the warehouse was burnt out, and the Fire Insurance Company settled the claim in respect of both items for a lump sum of £4,000. (*Royal Society Arts.*)

14. Set out below is an extract from the first Balance Sheet of Rubber Plantations, Ltd.:—

BALANCE SHEET.

(CREDIT SIDE.)

		£
Property Account—		
Purchase Price as per Agreement with Vendor		100,000
Expenditure on development during the year	£25,862	
Less Rubber sold	981	
		24,881
London Office Expenses	1,484	
Less Transfer Fees	121	
		1,363
		126,244
Plantation Loans Outstanding		1,281
Cash at Bank		5,872
Bills Receivable		1,200
Preliminary Expenses		1,524
		£136,121

If you do not approve of the treatment of the figures set out in the above extract, criticise and amend it. (*Royal Society Arts.*)

15. The firm of A., B. & Co. has branches in London and Paris.

For 1924, A. takes the whole of the London profit, and B. manages the Paris branch for a salary of £1,500.

The expenditure in Paris commenced on January 1, 1924, and until December 31, 1924, was all for Buildings, etc., and Advertising. Some goods were, however, forwarded from London in December 1924 for sale in 1925. The goods were invoiced by London to Paris at market price, but charged to Paris in the London books at cost; Paris paid 4,000 francs duty thereon.

The balances on December 31, 1924, were as follows :—

	London Books.	Paris Books.
	£	Fcs.
Creditors	7,700	80,000
Debtors	15,000	—
Buildings, etc.	10,000	250,000
Cash in hand and Balances at Bankers	4,000	76,000
Duty	—	4,000
Capital at January 1, 1924	(A.) 20,000	(B.) 100,000
Addition to Capital on August 31, 1924	—	(B.) 210,000
Drawings	(A.) 2,000	(B.) 70,000
London	—	(Cr.) 160,000
Paris	(Dr.) 1,700	—
Stock	2,000	80,000
Profit	7,000	—
Advertising	—	70,000

Interest is to be taken at 5 % on Partners' Capital and additions thereto, but not on drawings.

Rates of Exchange can be taken as follows :—

Average for 1924	70
Throughout December 1924	80
Remittances from London to Paris	80
B. paid in his Capital, 100,000 francs at 50 and 210,000 at	70
Fixed Assets were purchased at	50

Prepare the firm's Balance Sheet as on December 31, 1924. (*Chartered Accountants.*)

16. The Company to which you are a Secretary has an Investment in A. B. & Co., 10 % Debentures. From the following particulars prepare the Investment Account in the General Ledger :—

19 . . . January 1st. Purchased £5,000 Debentures at 98, brokerage and stamps £62 10s.

March 31st. Sold £2,500 Debentures at 101, brokerage £6 5s.

Interest is payable half-yearly on June 30th and December 31st and received on due dates. Income Tax at 4s. 6d. standard rate. Balance the Account at December 31st. (Interest to be calculated by quarters, not days.) (*Incorporated Secretaries.*)

17. A limited company obtained a loan of £15,000 from its bankers, and deposited 200 of the company's 6 % Debentures of £100 each as security.

The company had previously made a public issue of 300 6 % Debentures at 98, all of which had been subscribed and paid up.

How should these issues be stated in the company's Balance Sheet? (*Chartered Institute Secretaries.*)

18. United Investors, Ltd., derives its income primarily from dividends from holdings of stocks and shares of a considerable number of different companies.

Suggest a ruling for the Investment Ledger which will enable the accountant to trace easily the various dividends, etc., received over a period of years from any given holding. Assuming that the Company balances its

books yearly on December 31st, set out a *pro-forma* account showing the history of an investment made in May 1920, which paid dividends regularly in November and, in November 1922, made in addition a bonus distribution of shares, the holding being finally realised at a profit in February 1925.

How do you consider the profit on sale should be dealt with? (*London Chamber Commerce.*)

19. How would you deal with the following items when closing the accounts of a limited company for the year ended December 31, 19.. ?

(1) Issue on July 1st, 100 Debentures at 97, repayable in ten years from date of issue at par. (2) Brokerage and Expenses incurred in connection with the issue of the above Debentures, £250. (3) £1,000 Reserved for Income Tax. (*Incorporated Secretaries.*)

20. When preparing the Balance Sheets of the limited companies concerned hereunder, how should you arrive at the correct values to place upon the undermentioned items :—

(*a*) Loans on Policies (advanced by an Assurance Company to its policy holders). (*b*) Rents on the companies' properties outstanding at the close of the financial year. (*c*) Preliminary Expenses, including a considerable amount due for underwriting a new issue of Capital. (*Royal Society Arts.*)

21. In 1923 Soleil d'Or, Ltd., purchased 300 Ruritania 6 % Bonds repayable in 1931 at par. The Bonds were purchased at £108, and the expenses amounted to £96 4s.

Describe any entries you may consider necessary for dealing with the above investment in the books of the Company. (*Royal Society Arts.*)

22. In a Balance Sheet, Investments sometimes appear valued at their current market price; in other cases they are stated at cost price. Which, in your opinion, is the more correct method? Give reasons for your reply, and state what course should be followed where the ruling market prices are greatly below the cost price. (*Incorporated Accountants.*)

23. Discuss briefly the case of *The Ammonia Soda Company, Ltd.*, v. *Chamberlain*, and state your opinion of the decision from an auditor's point of view. (*Chartered Accountants.*)

24. "The value of the goodwill of a business naturally fluctuates in sympathy with the commercial success of the undertaking."

Comment on this statement, and give your opinion as to whether such fluctuations should be recorded in the books and accounts of the concern. (*Royal Society Arts.*)

25. The Nominal Capital of Crawfords, Ltd., consisted of 250,000 shares of £1 each, of which 200,000 had been issued and fully paid up.

In order to bring the book value of their assets more in accord with present day values, the Company decided: (*a*) To add £20,000 to the Plant and Machinery Account. (*b*) To add £15,000 to the Freehold Factory Account. (*c*) To add £15,000 to the Goodwill and Trade Marks Account. (*d*) To issue the balance of the Ordinary Share Capital, amounting to £50,000, as a bonus of one fully paid share of £1 for each four shares held.

Submit the entries necessary to record the above transactions in the Company's books. (*Royal Society Arts.*)

26. It has been stated that "the decisions in the *Lee* v. *Neuchatel Asphalte Co.* series of cases relieve limited companies from the obligation to provide for depreciation on fixed assets."

What is your opinion of the statement from the point of view of: (*a*) The legal decisions referred to? (*b*) Commercial policy? (*Chartered Accountants.*)

27. Criticise the following Balance Sheet and re-draft it in the form you would be prepared to certify it. Taking assumed figures for the purpose of splitting any item, state concisely the information and explanations you would require as Auditor, and draft your Report to the Shareholders.

LIABILITIES.

		£ s. d.	£ s. d.
Capital Issued :—			
6,027 6 % Cumulative Preference Shares of £1 each		6,027 0 0	
3,100 Ordinary Shares		3,100 0 0	
		£9,127 0 0	
Deduct :—			
Uncalled Capital	£162 10 0		
Calls Unpaid	207 10 0		
		370 0 0	
			8,757 0 0
Sundry Creditors on Open Accounts, Bills Payable, and Reserve for Sundry Expenses			2,385 4 1
Suspense Account			259 11 5
Payments made by Customers for Work in Progress			113 1 0
Reserve for Depreciation			138 16 0
Profit and Loss Account		1,960 7 3	
Less : Income Tax	£15 0 6		
Law Costs	60 6 0		
		75 6 6	
			1,885 0 9
			£13,538 13 3

ASSETS.

	£ s. d.
Machinery, Fixed and Loose Plant, Fixtures, Fittings and Office Furniture	7,007 16 2
Sundry Debtors, including Loans to Directors	2,056 3 6
Loans	43 0 0
Stock, including Work in Progress	2,018 14 4
Insurances and Salaries paid in advance	248 7 4
Purchase Account	966 14 8
Forfeited Shares	50 0 0
Shares held in Trust	100 0 0
Cash at Bankers and in hand	1,047 17 3
	£13,538 13 3

(*Incorporated Accountants.*)

28. The undermentioned assets are the property of the Reliance Boot Manufacturing Co., Ltd. How should they be valued for Balance Sheet purposes? (*a*) Twenty debentures of £100 each in the Southern Railway of America, representing the investment of the Reserve Fund. The debentures were purchased at par, but the market price has since fluctuated between 94 and 108, the former quotation being the mean market price as on December 31, 19.., the date upon which the Balance Sheet of the Reliance Boot Manufacturing Co., Ltd., is prepared. (*b*) Patents, £2,000. This amount represents the original cost of the patent rights in a welting machine. The grant of letters patent is dated January 1, 1906. (*c*) Goodwill, £5,000. This asset was purchased in 1905, at the price named, upon the formation of the limited company. The trading profits have steadily declined from £4,200 to £2,124 in four years. (*London Chamber Commerce.*)

29. The business of Bruce Bros. & Co. was registered as a limited company with a nominal capital of £400,000, divided into 4,000 shares of

£100 each. 500 of these shares were issued as fully paid in part payment of the purchase price of the business. 3,200 of the remaining shares were allotted to the public, and fully called up. 25 4½ % Debentures of £1,000 each were also issued and taken up.

On December 31st, the following accounts remained open in the Company's books: Share Capital Account, £320,000; Fully Paid Shares Account, £50,000; Land and Buildings, £282,000; Sundry Creditors, £18,485; Investments, £8,450; Cash, £6,200; Preliminary Expenses Account (Balance), £1,250; Goodwill Account, £15,000; Calls in Arrear, £525; Debenture Account, £25,000; Stock Account (December 31st), £9,000; Plant Account, £78,580; Sundry Debtors, £28,000; Reserve Fund, £8,000; Profit and Loss Account (undistributed balance), £7,520. Prepare a Balance Sheet as on December 31st. (*London Chamber Commerce.*)

30. Roses, Ltd., was registered in 19.. with a nominal capital of £100,000, divided into 50,000 Ordinary Shares of £1 each, and 50,000 6 % Preference Shares of £1 each. The Company was formed to acquire an old-established business. The purchase price was agreed at £50,000, payable as to £15,000 in Ordinary Shares, £15,000 in Preference Shares (both fully paid), and £20,000 in cash. The balance of both classes of shares was offered to the public and fully subscribed, and the amounts due, 5s. per share on Application, and 5s. on Allotment, were paid. The assets and liabilities taken over (at agreed values) from the old company were as follows: Freehold Works, £15,000; Plant and Machinery, £6,000; Stock, £4,000; Sundry Debtors, £12,000; Patents, £4,000; Sundry Creditors, £1,000. Give the Journal entries necessary to record the above transactions in the books of the Company, open its Ledger and show its initial Balance Sheet. (*Royal Society Arts.*)

31. The following Balance Sheet was issued by the Eldorado Plantations, Ltd.:—

BALANCE SHEET, DECEMBER 31, 19..

DR.	£	£			CR. £
Issued Share Capital	190,000		Leasehold Land, Buildings, and Machinery at cost		200,000
Less Calls in arrear	8,000	182,000	Railway, Wharf, Motor Boats, Live Stock, etc., at cost	£12,000	
Bank Loan		48,000	*Less* Depreciation	500	11,500
Sundry Creditors		3,647	Expenditure on 19.. Crop to date		48,400
Bills Payable		32,100	Expenditure on 19.. Crop to date		685
Profit and Loss Account— Profit for the year	9,120		Advances to Coolies and Sundry Debtors		6,850
Less Interim Dividend paid	9,100	20	Exchange Suspense Account		392
Depreciation Fund		5,000	Cash on Plantation		1,850
			Cash at Bankers in London		1,090
		£270,767			£270,767

You are asked to criticise this Balance Sheet from the point of view of a prospective shareholder. If you desire any further information before giving your opinion, submit the letter which you would address to the secretary of the company. (*Chartered Institute Secretaries.*)

32. The directors of a limited company issued the understated account to their shareholders. Do you approve of this document? If not, what amendments do you suggest?

BALANCE SHEET, DECEMBER 31ST.

DR.	£		CR. £
To Share Capital	500,000	By Land, Buildings, Plant, Stock, Furniture, and Goodwill	1,007,000
,, Reserve Fund	100,000	,, Debtors, Cash, Investments, and Sundry Debtor Balances ..	166,000
,, Sinking Fund for Leases	10,000		
,, Mortgages and other outstanding Liabilities ..	535,000		
,, Balance carried down ..	28,000		
	£1,173,000		£1,173,000
	£		£
To Interim Dividend paid	25,000	By Balance brought down	28,000
,, Balance carried forward	3,000		
	£28,000		£28,000

(*London Chamber Commerce.*)

33. At a recent examination, the understated Balance Sheet was sent in by a candidate. Have you any criticism to offer upon it ?

BALANCE SHEET, DECEMBER 31ST.

Messrs. A. & B.

DR. ASSETS.		£	CR. LIABILITIES.		£
Plant Account		4,000	A.'s Capital	£3,000	
Debtors	£8,200		*Add* Interest	150	
Less Reserve (31/12/19..) ..	410				3,150
		7,790	B.'s Capital	£2,000	
A.'s Drawings		300	*Add* Interest	100	
B.'s Drawings		200			2,100
Repairs		120	Creditors		9,800
Stock (Jan. 1st)	£3,200		A.'s Profits		1,800
Stock (Dec. 31st)	4,000		B.'s Profits		1,800
		7,200	Depreciation on Plant		200
Cash		420	Reserve for Debtors (Jan. 1st)		350
			Balance		830
		£20,030			£20,030

(*London Chamber Commerce.*)

34. Criticise the Balance Sheet set out hereunder. If you do not approve of it, amend it.

Blanks, Limited.

BALANCE SHEET FOR THE YEAR ENDING DECEMBER 31, 19...

DR.		£		CR. £
Ordinary Share Capital.. ..	£86,000		Stock on hand	32,000
Less Forfeited Shares ..	400		Uncompleted Contracts	168,992
		85,600	Cash	2,210
Preference Share Capital		100,000	Goodwill and Trade Marks	56,000
Depreciation Fund		2,500	Plant and Machinery	24,600
Debentures—1,000 Debentures of £100 each, at 5 %, issued at 90		90,000	Sundry Debtors	10,200
Bank Overdraft and Sundry Creditors		15,862	Unpaid Calls	1,500
Profit for the year	£12,850			
Balance from last year	2,250			
	15,100			
Less Preference Dividend and proposed Ordinary Dividend	13,560			
		1,540		
		£295,502		£295,502

(*Chartered Accountants.*)

35. Report fully in what respect the following Balance Sheet is not in accordance with the Companies Consolidation Act, 1908, or established practice. Illustrate by re-drafting same in proper form.

BALANCE SHEET OF F.A.Q. CO., LTD., AS ON APRIL 1, 19...

Dr.		£	Cr.		£
To Stock-in-Trade		8,412	By Loan on Mortgage of Co.'s Property		20,000
„ Book Debts		16,201	„ Trade Liabilities		16,412
„ Buildings		41,120	„ Capital: £120,000 in Shares of £1 each, all issued, 10s. paid up	£60,000	
„ Plant and Machinery		79,480	„ *Less* 8,000 Shares cancelled, 10s. paid	4,000	
„ Profit and Loss Account	£8,978				56,000
„ *Less* Shares cancelled	4,000		„ Reserve Fund		14,500
		4,978	„ Debentures issued		40,000
„ Cost of Issue of Debentures		641	Bills payable		8,420
„ Bills receivable not yet due		4,500			
		£155,332			£155,332

I have examined the above Balance Sheet and find same correct.

X.Y.Z., *Auditor.*

(*Incorporated Accountants.*)

36. The following items have been extracted from the debit sides of various Balance Sheets: Marine and Fire Insurance Reserve; Dilapidations Reserve; Rebate on Bills not due (Bank); Forged Transfer Fund.

Give your interpretation of these items, and briefly state how they have been created in the books of the various companies. (*Royal Society Arts.*)

37. The following items appear on the assets side of the Balance Sheet of a limited company:—

			£
(*a*)	Discount and Expenses on Debentures issued during the year		8,500
(*b*)	Patents at Cost (granted seven years ago)		6,840
(*c*)	Leasehold Property at Cost	£10,000	
	Additions during the year	2,000	
			12,000

(Lease expires 5 years hence.)

If, in your opinion, any provision is necessary in order to reduce the book values of the above items, describe the principle upon which such provision should be based. (*Royal Society Arts.*)

38. The books of Tanner, Blacker & Co., Ltd., leather manufacturers and merchants, show the following balances on December 31st:—

Share Capital Authorised and Issued: 100,000 7 % Preference Shares of £1 each, £100,000; 200,000 Ordinary Shares of £1 each, £200,000. Freehold Land and Buildings, £216,000; Rent of Leasehold Premises, £500; Stores and Material on hand, January 1st, £30,000; Repairs of Buildings, £400; Rates, £2,780; Insurance Premiums, £350; Freight Charges Outwards, £700; Office Furniture, £250; Purchases, £90,000; Sales, £180,000, Balance at Bank, £4,500; Cash in hand, £500; Bills Receivable, £6,000; Bills Payable, £3,000; Wages, £16,000; Plant and Machinery at written down cost on January 1st, £115,000; Repairs to Machinery, £4,000; Salaries, £2,500; Sundry Trade Expenses, £1,620; Sundry Office Expenses, £750; Debtors, as per Sales Ledger, £6,000; Creditors, as per Purchases Ledger, £8,000; Directors' Fees, £1,000; Audit and Accountancy Charges, £150; Credit to Profit and Loss Account on January 1st, £8,000.

At December 31st, survey of the Stock shows its value at £50,000, and Work in Progress value £15,000.

Payments in Advance amount to £150 on account of Insurance, and £150 on account of Rates.

Provide £4,000 on account of Income Tax, £300 on account of accrued Wages, £5,000 for Contingencies Reserve, and £500 Provision for Bad Debts.

Depreciate Freehold Premises at the rate of 2 % per annum, and Plant and Machinery at the rate of 10 % per annum.

Prepare Trial Balances, and after making the necessary adjustments, prepare a Trading Account, a Profit and Loss Account, and a Balance Sheet. (*Incorporated Accountants.*)

[NOTE.—Students should also work some of the long Exercises which appear at the end of Chapter XII.]

CHAPTER VI

PARTNERSHIP

I. LEGAL

CONTRIBUTED BY E. B. V. CHRISTIAN, LL.B.

NOTE.—All references to Sections, etc., in this chapter are to the *Partnership Act*, 1890, unless otherwise stated.

THE Law of Partnership is one of the branches of the law that has been consolidated and codified, and is therefore easy of reference. The three governing Acts are :—

(1) *The Partnership Act*, 1890.—This is the Statute which codified and consolidated the law of partnership as it had been established by a long course of commercial usage and judicial decisions.

(2) *The Limited Partnership Act*, 1907.—This Act makes it possible to limit the liability of a partner, so that a partnership may comprise one or more general partners, exercising the ordinary powers, and subject to the ordinary liabilities of partners, and one or more partners with limited powers and limited liability ; but no partnership may consist solely of limited partners (*see* p. 132).

(3) *The Registration of Business Names Act*, 1916.—This Act, one of the War-time measures, compels registration of the true names of all the members of a partnership when the firm name of the partnership does not consist of those names (*see* p. 115).

It should be clearly understood, at the outset, that the relationship between partners may be whatever the partners mutually agree between themselves that it shall be, and that such agreement may be evidenced by writing, or be inferred as a fact from the course of conduct pursued by the partners. It is only in the absence of any agreement, express or implied, between partners, modifying or abrogating the provisions of the *Partnership Act*, 1890, that that Act regulates the partnership relation of the partners *inter se*.

Definition of Partnership.—" Partnership is the relation which subsists between persons carrying on business in common with a view of profit " (S. 1). Another definition suggested by Sir Frederick Pollock in his *Digest of the Law of Partnership* (11th edition, p. 4) is " Partnership is the relation which subsists between persons who have agreed to share the profits of a business carried on by all or any of them on behalf of all of them."

The Act declares (S. 2) that the relation between members of any company or association which is registered under the Companies Acts; or incorporated by any other Act of Parliament, or letters patent, or Royal Charter; or a company engaged in working mines within and subject to the jurisdiction of the Stannaries, is *not* a partnership.

The existence of a business is essential to the idea of partnership, and the term "business" includes every trade, occupation, or profession. The association of a number of persons for the purpose of forming a club, or a friendly society, or for charitable purposes, does not constitute those persons a partnership. Nor does the joint ownership of property by itself involve partnership. Two men may own a house and divide the net income derived therefrom without being partners. A may own a theatre and pay the general expenses of the theatre, B may provide and pay the acting company, and A and B share the gross receipts, without being partners (S. 2). But the use of the joint property for profit to be divided between the owners may create a partnership. If the joint owners of a house furnish it and let lodgings, and divide the profits, they are carrying on a business in partnership.

What Creates Partnership.—It is often important to ascertain whether a partnership exists, either to determine the rights of the parties between themselves, or (more often) that creditors may know by whom payment of their debts is to be made. Compulsory registration of partnerships, in cases where the firm name does not disclose the true names of the partners, has made the task easier; but since the partners may have failed to register, the tests of the existence of the partnership relation are still important.

The receipt by a person of a share of the profits of a business is *prima-facie* evidence that he is a partner in the business (S. 2 (3)). But this *prima-facie* evidence may be capable of rebuttal.

Where losses are shared as well as profits the presumption is stronger, but even that is not conclusive. If the agreement is in writing, the fact of partnership and the intention of the parties are to be deduced from the whole document. "The question is whether there was a joint business or whether the parties were intending to carry on the partnership as agents for each other" (*Hawksley* v. *Outram*, [1892]. See also *Cox* v. *Hickman*, [1860]).

The Act expressly declares that certain things shall not of themselves create a partnership:—

By S. 2, ss. (1) and (2), joint tenancy, tenancy in common [two methods of holding real property], joint property, common property, or part ownership [words appropriate to and covering both realty and personalty] does not of itself create a partnership as to anything so held or owned, whether the tenants or owners do or do not share any profits made by the use thereof. Nor does the sharing of gross

returns, whether or not the persons sharing have a joint interest in the property from which the returns are made.

By S. 2 (3), the receipt by a person of a share of the profits of a business, or of a payment contingent on or varying with the profits of a business, does not of itself make him a partner in the business; and in particular

(*a*) The receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business, does not of itself make that person a partner in the business.

(*b*) A contract for the remuneration of a servant or agent of a person engaged in business by a share of the profits of the business, does not of itself make the servant or agent a partner in the business.

(*c*) The receipt by the widow or child of a deceased partner by way of annuity of a portion of the profits made in the business, does not of itself make the widow or child a partner in the business.

(*d*) A loan to a person or to partners engaged or about to engage in any business on a contract that the lender shall receive a rate of interest varying with the profits, or a share of the profits, does not of itself make the lender a partner in the business, *provided* that the contract is in writing and signed by or on behalf of all the parties thereto.

(*e*) The receipt by a person by way of annuity or otherwise of a portion of the profits of a business in consideration of the sale by him of the goodwill of the business, does not of itself make the recipient a partner in the business.

But the lender in (*d*) and the vendor in (*e*), if the borrower or the purchaser becomes a bankrupt, or enters into an arrangement with his creditors to pay them less than 20s. in the £, or dies insolvent, cannot recover anything for his loan or sale of the goodwill until all other persons who are creditors at the date of the insolvency are paid in full (S. 3). A pretended repayment and fresh advance will not evade the statute. But a genuine repayment and advance on different terms may enable the lender to rank *pari passu* with the other creditors.

Firm Name.—Persons who have entered into partnership are called collectively a "firm," and the name under which the business is carried on is the "firm name." A man may in England call himself by any name he chooses, and a firm may take any name it likes, provided no fraud is intended thereby. There is not property in a firm name as there is in a trade mark, but the Courts will prevent a name being assumed, or used, in such a way as to induce the public to believe that they are dealing with persons already known by the same name. So the partners carrying on the business of Day & Martin, blacking manufacturers, who had acquired their rights from the original producers, although no partner remained bearing either of those names, obtained an injunction against a Mr. Day and a Mr. Martin,

who also traded as blacking manufacturers. But there must be intent to deceive before the Court will grant an injunction.

Registration of Business Names.—There was formerly no registration of firms, and it was often difficult to ascertain who were the partners. Under the *Registration of Business Names Act*, 1916, there must be registration of any firm name which does not consist of the true surnames of all the partners, without any addition, except the Christian names (or first or forename) or the initials, or recognised abbreviations of these names.* The registration must disclose the business name, the nature of the business, the principal place of business, and in respect of each partner his present Christian name and surname, and any former Christian name and surname, his nationality, and his nationality of origin if that is different, his usual residence, and other business occupation, if any. The date of the commencement of the business must be stated if it began after 22nd December, 1916.

Not only must the partners' names and nationality, if not British, be registered, but these particulars must be stated in all trade catalogues, circulars, showcards, and business letters. Curiously enough, invoices are omitted from this list of documents.

The penalty for not registering is a fine not exceeding £5 per day while the default continues. But there is a further consequence, the extreme severity of which marks the War-time origin of the Statute. A firm in default cannot enforce any contract by process of law. No debt due to a firm that ought to be registered, but is unregistered, can be recovered. The Courts have power to grant relief where non-registration is accidental, or inadvertent; or where circumstances make it just and equitable to grant relief; and, in fact, relief is generally granted subject to terms as to costs.

The firm name is merely a short way of referring to the partners collectively. A firm is not in England a separate entity, i.e. a legal person. Scots law differs in this respect.

Partnership Must be Legal.—No partnership to carry on the business of banking may have more than ten partners, nor any other business more than twenty.† And the objects of the partnership must be legal. The allegation of a partnership between highwaymen in an action for accounts was visited with serious consequences, not only to the parties, but also to solicitor and counsel who appeared for the plaintiff. A partnership for selling smuggled goods is illegal, or for bookmaking contrary to the *Betting Act*, or secret pawnbroking. A solicitor cannot enter into partnership with a person not a solicitor; partnership cannot exist between barristers.

Infant as Partner.—A partner must be capable of contracting. An infant is not bound by a partnership contract and may repudiate, or

* The Act applies also to an individual carrying on business in a name other than his own.

† (*Companies Act*, 1929, SS. 357 and 358.)

adopt, the contract on his coming of age, but he cannot recover any premium paid if he has derived real benefit from the contract. Where a firm with an infant partner is insolvent, a receiving order cannot be made against the whole firm, but may be made against the firm other than the infant partner.

The Partnership Agreement.—A partnership agreement need not necessarily be in writing. A written contract is extremely desirable; but (unless the partnership is for a period of more than one year, in which case, by the provision of the *Statute of Frauds*, the agreement must be in writing) an oral agreement is valid. Written agreements are sometimes under seal, sometimes under hand only. An unsigned draft agreement, if acted upon by the partners, or an informal memorandum, initialled by the partners, and intended as instructions for a formal document, may be evidence of the terms of partnership. The original agreement, even if in writing, may be varied by oral agreement, and a mode of dealing in which all the partners have acquiesced is evidence of such a variation. With respect to a partnership agreement, it is to be observed, that all parties being competent to act as they may agree amongst themselves, they may, by mutual consent, put an end to it or vary it at any moment. The terms of such variations may be evidenced in writing, or solely by the conduct of the parties, and their mode of conducting the business (*England* v. *Curling*, [1844]).

But although it has been held that usage, uniform and without variation, not strictly in accordance with the Articles of Partnership, is evidence of a new agreement by the partners, and is as binding as if it had been originally clearly prescribed by the Articles, yet where Articles of Partnership provided that the share of a deceased partner in the assets should be ascertained by reference to the annual account made up to the 30th of April next after his death, and there had not been any case of death during the continuance of the partnership, it was held that there could be no practice or usage uniform and without variation, since the case had never arisen; and further that the assets should be taken at their fair value at the date of the account, and not at their value appearing in the books of the partnership (*Cruikshank* v. *Sutherland*, [1922]).

Contents of Partnership Agreement.—A partnership agreement or deed (for it may be under hand or under seal), if it is to deal with all the matters to be regulated, cannot well be short. Brevity is generally achieved only at the cost of incompleteness, though where the terms provided by the *Partnership Act* are such as the parties desire, it is possible to shorten the document to some extent. But Lord Lindley has pointed out that such omissions are not to be recommended. It is desirable that the partnership agreement shall be, as far as possible, a complete code to which the partners may refer, should need arise. A partnership agreement usually deals with the following matters :—

(*a*) The firm name, the business to be carried on under that name, and the address or addresses at which the business is to be transacted.

(*b*) The commencement and duration of the partnership.

(*c*) Power for a partner to retire after notice given, if that is agreed.

(*d*) The capital of the partnership fixed or otherwise, and the shares in which the partners are to be entitled to it. Interest on capital.

(*e*) Provisions for bringing in further capital, and for loans by partners to the firm. Interest on loans.

(*f*) The proportion in which profits and losses are to be divided between the partners.

(*g*) Partnership salaries, if any. In the absence of agreement no salary is payable.

(*h*) The drawings of the partners. Interest on drawings.

(*i*) The bankers of the partnership. All moneys received to be paid into the bank. Powers of partners to sign cheques, accept bills, etc.

(*j*) The payment of rent and other necessary outgoings.

(*k*) The duties of the partners, such as requiring them to be just and faithful to the others, to render accounts, and to devote their whole time to the conduct of the business, or such time as may be agreed.

(*l*) Such restrictions as preclude a partner from being concerned in any other business, or engaging or dismissing clerks without the consent of the other partners, or pledging the credit of the firm except in the ordinary course of business, or giving credit to forbidden persons, or entering into contracts in excess of a stipulated sum without the consent of the other partners.

(*m*) Further restrictions preventing a partner from becoming bail, or surety, or security for persons outside the partnership, or assigning or charging his share in the partnership business, or releasing debts due to the firm, and a stipulation that each partner shall pay his own private debts, and indemnify the firm's property against private claims made upon him.

(*n*) The keeping of proper books of account. Books always to be available for inspection by any partner. The periodical taking of accounts. Arrangements for audit, if any.

(*o*) The creation of a reserve fund.

(*p*) Provision that the death or retirement of one partner shall not dissolve the partnership as regards the remaining partners.

(*q*) The winding-up of the business on the determination of the partnership, with or without special stipulation as to the value of the goodwill. It is usual to have a clause enabling surviving or continuing partners to purchase the share of a deceased or retiring partner, and, frequently, to pay the purchase money by instalments;

with or without giving security for the unpaid balance. Interest is usually payable on the outstanding balance. Joint assurance policies on the partners' lives are sometimes taken out in order to provide the necessary funds for this purpose.

(*r*) Provisions as to basis on which the goodwill and other assets of the business are to be valued on the death or retirement of a partner.

(*s*) Power for a partner to bring a son into the firm.

(*t*) Power in the event of gross breaches of duty by one partner for the other partners to expel him from the firm, and to enable them to sign any document necessary for effecting the expulsion.

(*u*) An arbitration clause. This is more valuable in the case of a partnership than in many other cases where arbitration is resorted to. Questions arising between partners, often involving the taking of accounts, are better determined in the quiet and privacy of the arbitration room than they are in Court.

Numerous variations in these clauses may be made to meet special circumstances and needs.

Relations of Partners to Persons Dealing with Them.—It is the characteristic feature of partnership law that a partner is both a principal and an agent : a principal binding himself by his acts done on behalf of the firm, and an agent by the same acts binding his partners. Every act of a partner, carrying out in the usual way business of the kind transacted by the firm, binds the partners, unless, in fact, the partner had no authority to act for the firm in the particular matter, *and* the person with whom he deals either knows that he has no authority, or does not know or believe him to be a partner (S. 5).

Whatever private arrangements partners have between themselves, the persons dealing with them are entitled to assume that in matters within the scope of the partnership business each partner is authorised to bind the firm. In a trading partnership,* therefore, every partner may bind the firm by selling the firm's goods, buying goods on account of the firm, receiving payment of debts due to the firm, engaging servants for the partnership business, accepting bills, borrowing money on the firm's credit, pledging the firm's goods, or creating an equitable mortgage by deposit of deeds. On the other hand, one partner cannot bind the other partners by deed without express authority, nor can he bind the firm by giving a guarantee in the name of the firm, even if it is a reasonable and convenient thing to do in the circumstances, unless it is the custom of the firm, or the general custom of firms engaged in the same business, so to do.

If the firm is a non-trading firm there is no implied authority

* A trading business is one which involves the purchase and sale of goods. But not every business which involves the expenditure of money for goods which the business requires is a trading business. A partnership for the purpose of running a cinema is not a trading business (*Higgins* v. *Beauchamp*, [1914]).

to borrow. Architects, e.g., do not usually borrow money, so that there is no implied power for an architect to bind his firm by borrowing. Nor is there implied power for partners of a non-trading partnership to accept bills, or pledge chattels * on behalf of the firm. At least the onus is on a claimant to prove that giving bills or pledging chattels is usual or necessary in the business.

Where there is what is called a *dormant* or *sleeping partner*, usually a partner who contributes capital to the firm, and receives a share of the profits, but who takes no active part in the management of the business, and does not hold himself out as being a partner, or disclose his name in the firm name, the presumed agency of the active partners is probably rebutted. But it is more difficult now than it was formerly for such a state of things to arise, in view of the need for registration.

When a partner exceeds his authority, the other partners may adopt the transaction. If they do so they are bound by it. They may be bound, also, if they have notice of the transaction and do not repudiate it. A mere complaint to the partner exceeding his authority, not followed by any other step, would probably be held insufficient repudiation, and the firm would be bound.

Where money borrowed by *one partner*, in the name of the firm, without the authority of his co-partners, has been applied in paying off debts of the firm, the lender is entitled to repayment by the firm of the amount which he can show to have been so applied. And the same rule extends to money *bona fide* borrowed and applied for any other legitimate purpose of the firm (*Lindley on Partnership*).

Where a partner pledges the credit of the firm for a purpose apparently not connected with the firm's ordinary course of business, the firm is not bound, unless he is in fact specially authorised by his partners; but this does not affect any personal liability incurred by an individual partner (S. 7).

Questions arise sometimes when a partner raises money by giving negotiable securities in the firm name for the purpose of satisfying his private debt, or pays his private debt out of partnership funds. The person lending money in such a case must be prepared to show that the partner had in fact authority to act as he did, or that the other partners had so acted as to give reasonable ground for supposing that such authority had been given, in which case the firm may be bound by estoppel.†

* *Chattels.*—Goods movable, e.g. oxen, furniture, jewellery, etc. (*chattels personal*) and goods immovable, e.g. an interest in land, other than a freehold interest (*chattels real*), which belong immediately to the person of the owner are termed *chattels*, as opposed to *choses in action*, e.g. debts, bonds, etc., of which a man has not the actual possession, but to which he has rights enforceable at law.

† *Estoppel.*—If one person, A, either by his words or his conduct induces another person, B, to believe in a state of facts and act upon that belief, then A may be *estopped*, i.e. precluded from setting up the real facts, and the rights as between A and B may be regulated not by the state of the facts as they actually are but by the state of the facts as A represented them to be.

If the partners agree that a restriction shall be placed on the authority of one or more partners to bind the firm, nothing done in contravention of the agreement is binding on the firm with respect to persons having notice of the agreement (S. 8). But, of course, the restriction does not affect persons having no such notice.

Liability of Partners.—Every partner in a firm is liable jointly with the other partners, and in Scotland severally [= separately] also, for all debts and obligations of the firm incurred while he is a partner; and after his death his estate is also severally liable in a due course of administration for such debts and obligations, so far as they remain unsatisfied, but subject in England to the prior payment of his separate debts (S. 9).

Where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the firm, or with the authority of his co-partners, loss or injury is caused to any person not being a partner in the firm, or any penalty is incurred, the firm is liable therefor to the same extent as the partner so acting or omitting to act (S. 10).

The firm is liable to make good a loss :—

(*a*) Where one partner, acting within the scope of his apparent authority, receives the money or property of a third person and misapplies it ; and

(*b*) Where a firm in the course of its business receives money or property of a third person, and the money or property so received is misapplied by one or more of the partners, while it is in the custody of the firm (S. 11).

The liability under S. 9 is joint ; under SS. 10 and 11 it is joint and several.

If judgment is recovered against the firm on a joint liability, each partner is liable for the whole amount of the judgment. But if the plaintiff sues individual members of the firm, and recovers judgment, he cannot afterwards sue other partners, even if he did not know that they were partners when he recovered judgment (*Kendall* v. *Hamilton*, [1879]). The defendant in such an action may apply to the Court to order that the other joint debtors be added as defendants. Since the estate of a deceased partner is severally liable, the fact that judgment has been obtained against the firm does not prevent the creditor suing the personal representatives.

Where the liability is joint and several, the fact that judgment has been obtained against one partner does not prevent the creditor suing the other partners.

Enforcing a Judgment Against a Firm.—Where a creditor of a partnership has secured judgment against a firm he may issue execution against any property of the partnership. He may also issue execution against the goods of an individual partner who was personally

served with the writ as a partner, and has not entered an appearance, or who has appeared in his own name as a partner, or has admitted on the pleadings that he is a partner. If the plaintiff seeks to issue execution against a person who has not been so served, or who has not appeared as a partner, or admitted that he is one, he must apply to the Court for leave. If the fact of partnership is then denied, the Court will first hear and decide the issue whether the respondent is a partner.

Liability for Wrongs.—It is essential in order to establish liability to show that the wrongful act was done in the ordinary course of the partnership business.

A and B are solicitors practising in partnership. C, a client of the firm, entrusts money to A to be invested in a specific security. A misappropriates the money. B knows nothing of the transaction. B is liable since it is part of the ordinary business of solicitors to invest in specified securities (*Blair* v. *Bromley*, [1847]). But in a case similar except that C gave to A only general instructions to invest the money as A thought fit, B is not liable for A's misappropriation of the money, since it is not the ordinary business of solicitors to receive money to be invested at their discretion (*Harman* v. *Johnson*, [1853]).

The question is whether the wrongdoer was acting as agent for the firm and within the apparent scope of his agency.

If a partner, being a trustee, improperly employs trust-property in the business or on account of the partnership, no other partner is liable for the trust-property to the persons beneficially interested therein, unless he has had notice of the breach of trust; but if the money is still in the firm's possession or under its control, the beneficiaries may follow and recover it (S. 13).

Holding Out.—A person may become liable as a partner without actually being one, if he "holds himself out" to be a partner. If he represents himself to be one, or knowingly allows himself to be so represented, and on the faith of such representation credit is given to the firm, he is liable to the creditor. He is estopped from denying the character which he has assumed, and on the faith of which the creditor acted (S. 14 (1)). A man who has retired from a firm, but has given no notice of dissolution of partnership, and allows his name still to be used as part of the firm name may be liable on this ground. But the continued use of a deceased partner's name as part of the firm name does not of itself impose any liability on the deceased partner's estate for partnership debts contracted by the firm after his death (S. 14 (2)).

Incoming and Outgoing Partners.—A person admitted as a partner into an existing firm does not thereby become liable to creditors of the firm for anything done before he became a partner. A retiring partner does not cease to be liable for debts incurred before his retirement (S. 17). An agreement by continuing partners to indemnify

a retiring partner is usual; and if the creditor by express agreement, or agreement to be implied from the course of his dealing with the new firm, consents to look to the new firm for payment, then the retiring partner is discharged from liability. There is then a novation of contract, i.e. the creditor has expressedly or impliedly accepted the new firm as his debtors instead of the old.

A and B were bankers in partnership, C and D were admitted as new partners, and notice was given to all creditors. A died, and subsequently B died. C and D continued to carry on the business, but became insolvent. Depositors who knew of A's death, but had continued afterwards to receive interest on their deposits, and had proved as creditors in the bankruptcy of C and D, cannot afterwards sue A's estate (*Bilborough* v. *Holmes*, [1876]).

A mere agreement between the old partners and incoming partners that the new firm shall discharge the old firm's debts does not give to the old firm's creditors a right to sue the new firm. There must be an agreement between the firm as newly constituted and the creditor before action by him will lie against the new firm. Creditors cannot enforce a contract to which they are not parties.

A continuing guarantee given either to a firm or to a third person in respect of the transactions of a firm, is revoked as to future transactions by any change in the constitution of the firm, unless the contrary is agreed (S. 18).

Relationship of Partners to One Another.—The mutual rights and duties of partners, whether stated in a partnership agreement or defined by the Act, may be varied by the consent of all the partners, and such consent may be given expressly, or be inferred from a course of dealing (S. 19). So where articles of partnership provided for a valuation of partnership property, to be made on the annual account day, for the purpose of settling partnership profits, and a valuation was for many years made and acted on by all the partners, it was not open to a partner or his personal representative to challenge the accepted mode of valuation, even though inconsistent with the terms of the articles (*Coventry* v. *Barclay*, [1864]).

All property originally brought into the partnership stock, or acquired by purchase or otherwise on account of the firm, or for the purposes and in the course of the partnership business, is partnership property, and must be held by the partners exclusively for the purpose of the partnership in accordance with the partnership agreement; and, unless a contrary intention appears, property bought with money belonging to the firm is deemed to have been bought on account of the firm (SS. 20, 21). So, when a firm bought land and the conveyance was taken in the name of one partner, the land was partnership property. Where one partner bought shares in his own name and without the authority of the other partners, but with the money and on account of the firm, the shares were partnership property. A partner renewing

the lease of partnership offices in his own name holds the lease in trust for the firm.

Where any land, or any heritable interest therein has become partnership property, it shall, unless the contrary intention appears, be treated as personal or moveable estate, not real estate (S. 22). Land acquired for partnership purposes was usually conveyed to the partners as tenants in common; but, by S. 24 of the *Law of Property Act*, 1925, an undivided share of land is not now capable of being created, and where land is conveyed to persons in undivided shares the conveyance takes effect as if conveyed to them as joint tenants upon "the statutory trusts." These trusts are to sell the property (but with power to postpone the sale) and to stand possessed of the net proceeds of sale so as to give effect to the rights of the persons interested in the land. Freehold or leasehold property belonging to the partnership will, therefore, be held in future upon trust for sale; but no sale will be made until the persons holding the majority of the interests desire a sale, and presumably their right to require a sale will be controlled by the terms of the partnership agreement. Obviously a sale of the premises where the partnership business is carried on might ruin the business.

Rights and Duties of Partners *inter se*.—The Act contains important rules declaring the rights and duties of the partners. By S. 24 the interests of partners in the partnership property and their rights and duties in relation to the partnership shall be determined, *subject to any agreement expressed or implied between the partners*, by the following rules:—

(1) All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses whether of capital or otherwise sustained by the firm.*

(2) The firm must indemnify every partner in respect of payments made and personal liabilities incurred by him—

- (*a*) In the ordinary and proper conduct of the business of the firm; or
- (*b*) In or about anything necessarily done for the preservation of the business or property of the firm [such as money found to pay a pressing debt].

(3) A partner making, for the purpose of the partnership, any actual payment or advance beyond the amount of capital which he has agreed to subscribe, is entitled to interest at the rate of five per cent. per annum from the date of the payment or advance.

* The skill of a partner may be of value to the firm out of all proportion to the capital he brings in. Where the partners have not apportioned profits the Court will not do so. "Equality is equity, not as being absolutely just, but because it cannot be known that any particular degree of inequality is more just" (Pollock, *Digest of the Law of Partnership*, p. 83).

(4) A partner is not entitled, before the ascertainment of profits, to interest on the capital subscribed by him.

(5) Every partner may take part in the management of the partnership business. [By agreement the management may be delegated to one or more partners and such an agreement is binding.]

(6) No partner shall be entitled to remuneration for acting in the partnership business. [But compensation may be received by one partner for extra trouble occasioned by another's neglect of business.]

(7) No person may be introduced as a partner without the consent of all existing partners. [This is a fundamental principle of partnership law. Partnership is based on the personal confidence of partners in one another. The introduction of a stranger is contrary to the basis of a partnership. A partner may indeed assign his share and this (unlike a charging order on a share under S. 23) does not necessarily give a right to the other partners to dissolve the partnership ; but the Court might consider that such an assignment makes it just and equitable to order a dissolution.]

(8) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners. [Any such decision must be made in good faith for the benefit of the partnership as a whole and every partner must have an opportunity of being heard.]

(9) The partnership books are to be kept at the place of business of the partnership (or the principal place, if there is more than one), and every partner may, when he thinks fit, have access to and inspect and copy any of them. A partner may employ an agent for this purpose, provided that the other partners have no reasonable ground of objection to the particular agent selected, but the agent may not use the information derived from inspection for any other purpose than to advise his principal. [But the partner making such extracts has, after he has ceased to be a partner, no right to make use of them for purposes injurious to the firm.]

These rules, it will be noticed, are "subject to any agreement expressed or implied between the partners." They apply only so far as they are not contrary to any provisions on these points contained in the partnership agreement.

Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal personal representatives (S. 28). Partnership is a contract *uberrimæ fidei* [of the utmost good faith]. Between partners this is obviously essential.

Every partner must account to the firm for any benefit derived by

him without the consent of the other partners from any transaction concerning the partnership, or from any use by him of the partnership property, name, or business connexion (S. 29). It is because of this rule that any partner obtaining a renewal of the lease of partnership property in his own name is bound, if the other partners claim it, to treat this as held on behalf of the firm, and the rule would probably be the same even if the partner renewing had told the other partners that he intended to apply for a renewal for his own benefit. On the other hand if the lease is not renewable, and one partner purchases the property subject to the lease, he is entitled to hold it for his own benefit.

If a partner carries on a competing business without the consent of his partners, he must account to the firm for all profits made in that business (S. 30). If a partner in one firm carries on such a business with the other partner's consent, he must not use information obtained from the partnership for the benefit of the other business or to the prejudice of the firm.

Determination and Expiration of Partnership.—Where no fixed term has been agreed on for the duration of the partnership any partner may determine the partnership at any time on giving notice of his intention so to do to all the other partners (S. 26).

Where a partnership entered into for a fixed term is continued after that term has expired, and without any express new agreement, the rights and duties of the partners remain the same as they were at the expiration of the term, so far as is consistent with a partnership at will [i.e. one which continues so long as all the partners are willing]. It can therefore be terminated at any time. A continuance of the business by the partners, or such of them as habitually acted therein during the term, without any settlement or liquidation of the partnership affairs, is presumed to be a continuance of the partnership (S. 27). The terms of the old agreement continue to apply as far as practicable, e.g. an arbitration clause contained in an agreement for a fixed term still applies when the partnership is continued after the end of the term. But a clause providing for a notice of a certain length in order to terminate the partnership before the end of the specified term is not applicable.

A partnership deed usually contains powers for the majority of the partners to expel the remaining partner or partners; but unless such a power is expressly given there is no power of expulsion. Where such power exists it must be exercised in good faith and in strict compliance with the terms of the document. The conditions of good faith include reasonable preliminary warning and opportunity of explanation, and the fact that partners are expressly relieved from the duty of stating their reasons does not dispense them from the duty of acting in good faith.

Assignment of and Charges on a Partner's Share.—A partner cannot assign his share so as to make his assignee a partner, or introduce

a new partner into the firm without the other partners' consent. If a partner assign his share, e.g. by way of mortgage to secure a debt due from him, the assignee acquires no right to interfere in the management of the partnership business, or to inspect the books, or to require an account. The assignee is entitled only to receive the share of the profits to which the assigning partner would otherwise be entitled, and he must accept the account of profits agreed to by the partners. Upon a dissolution of the partnership, the assignee is entitled to the assigning partner's actual share of the partnership assets. He is not bound by any agreement between the partners for valuing the share, and is entitled to have an account taken as from the date of the dissolution in order to ascertain the true value of the share (S. 31).

Partnership Property and Partner's Separate Judgment Debt.—It is not possible to enforce a judgment obtained against an individual partner by issuing execution against partnership property. The judgment creditor can now enforce the judgment in respect of the partnership property only by obtaining an order charging the partner's interest in the partnership property and profits, for the judgment debt and interest thereon; and the Court may appoint a receiver of the partner's share (S. 23). This was an alteration effected by the Partnership Act: for at common law partnership property might be taken in execution for the separate debt of any partner, and the debtor's interest therein could be sold. The person obtaining such a charging order has no right to take part in the business nor does the order as a rule entitle a judgment creditor to have accounts rendered to him by the other partners.

The Court may order a sale of the debtor partner's interest. In that event the other partners may purchase it, and at any time they may redeem the interest charged. Or they may obtain an order for dissolution of the partnership.

Section 23, which regulates procedure against partnership property for a partner's separate judgment debt, does not apply to Scotland.

Dissolution of Partnership.—A partnership may be dissolved at any time by mutual consent of the partners.

In addition, subject to any agreement between the partners, a partnership may be dissolved, under S. 32, by :—

(*a*) Expiration of the term fixed for the partnership.

(*b*) If entered into for a single adventure or undertaking, by the termination of that adventure or undertaking.

(*c*) If entered into for an undefined time, by any partner giving notice to the other or others. [Such notice once given cannot be withdrawn without the consent of all the partners.]

Further, by S. 33, a partnership is dissolved by :—

(*d*) The death of a partner. [This dissolves the partnership as regard all the partners unless the contrary has been agreed.]

(*e*) The bankruptcy of any partner. [This also dissolves the partnership as regards all the partners unless the contrary has been agreed.]

(*f*) When a partner suffers his share of the partnership property to be charged under the Act for his separate debt, the partnership may at the option of the other partners be dissolved.

Again, by S. 34, a partnership is in every case dissolved :—

(*g*) By the happening of any event which makes it unlawful for the business of the firm to be carried on or for the members of the firm to carry it on in partnership. [E.g. partnership with an alien enemy. The outbreak of war in 1914 dissolved many partnerships. The term "alien enemy" includes persons of every nationality residing in an enemy country.]

Lastly, by S. 35, partnerships may be dissolved by the Court. On application by a partner, the Court may decree a dissolution :—

(*h*) When a partner is found lunatic, or is shown to the satisfaction of the Court to be of permanently unsound mind. Proceedings may be taken by the Committee of the lunatic or next friend or person having title to intervene, or by any other partner.

(*i*) When a partner becomes in any other way permanently incapable of performing his part of the partnership contract.

(*j*) When a partner has been guilty of such conduct as, regard being had to the nature of the business, is calculated prejudicially to affect the carrying on of the business.

(*k*) When a partner wilfully or consistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable for the co-partners to continue in partnership with him. [The degree of misconduct sufficient to induce the Court to dissolve a partnership is difficult to determine. Refusal to meet the partners in matters of business and continual quarrelling have been held sufficient, so also has a state of hostility which has become chronic and renders mutual confidence impossible ; but not mere squabbles and ill-temper. The Court will, if such a state exists, make an order on the application of either party, but under (*i*), (*j*), and (*k*) above will not act at the instance of the partner who is to blame.]

(*l*) When the business of the partnership can only be carried on at a loss.

(*m*) When it is just and equitable that the partnership should be dissolved. [It is said that the marriage of a female partner (which formerly dissolved a partnership) might make it just and equitable to order a dissolution.]

Rescission of a Partnership Agreement.—Where a person is induced by fraud or misrepresentation to become a partner, the Court will rescind the contract at his instance. In such a case a

partner seeking rescission is entitled to be indemnified against the liabilities which he has incurred owing to his becoming a partner. The extent of the indemnity is stated in the Act (S. 41). Without prejudice to any other right he is entitled :—

(*a*) To a lien, or right of retention of, the surplus assets, after satisfying partnership liabilities, for any sum paid by him for the purchase of his share in the partnership, and for any capital contributed by him.

(*b*) To stand in the place of the creditors of the firm for any payments made by him in respect of the partnership liabilities.

(*c*) To be indemnified by the person guilty of the fraud or misrepresentation against all the debts and liabilities of the firm. He is also entitled to recover damages from the person guilty of the fraud, and, where the Act gives him a lien for principal moneys mentioned in S. 41 (*a*) above, to interest on those moneys, and costs of the action. He is also entitled to interest on all payments made by him in respect of partnership liabilities.

Dissolution by an Arbitrator.—Where there is an arbitration clause referring all disputes to arbitration and a dispute arises involving the question whether the partnership has been or ought to be dissolved, the arbitrator has power to dissolve the partnership.

Consequences of Dissolution.—As a general rule a partner is not liable for the acts of his former partners after the dissolution of the firm or his retirement from it ; but to protect himself against third persons an advertisement of the dissolution should be inserted in the *London Gazette*, and as regards persons who have already had dealings with the firm a specific notice of dissolution must be given.

A and B, partners, execute a deed declaring the partnership dissolved as from January 1st. They do not discontinue the business or give notice of dissolution. On February 1st A indorses a bill in the partnership name to C, who is not aware of the dissolution. The firm is liable on the bill (*ex parte Robinson*, [1833]).

The practice of the *London Gazette* is to require that notices of dissolution shall be signed by all the partners or their legal representatives, and the signatures be verified by the statutory declaration of a solicitor. A notice not signed by all the partners must be verified by the statutory declaration of a solicitor stating that such notice is given pursuant to the terms of the partnership to which it refers.

If a partner has, notwithstanding dissolution, given his partners authority to act for him, he will be bound by anything done by them within the limits of such authority. In the absence of such an agreement, each partner has authority to bind the firm so far as necessary to wind up the affairs of the partnership, and to complete transactions begun but unfinished at the time of the dissolution, but

not otherwise (S. 38); but the firm is in no case bound by the acts of a partner who has become bankrupt.

A bill was indorsed in the name of a firm to a creditor. Before the bill became due the partnership was dissolved. Notice of dishonour given to the continuing partner, but not to the retiring partner, was *held* to be binding on the retiring partner (*Goldfarb* v. *Bartlett*, [1920]).

Money belonging to a trust estate was deposited with a bank, the receipt stating that it was to be paid to the firm of solicitors acting for the trust. The firm was dissolved. One of the partners indorsed the receipt and received, but did not pay over, the money. The beneficiaries under the trust sued the Bank. *Held* that as the receipt of the money was necessary, either to "wind up the affairs of the partnership" or "to complete a transaction begun but not finished before the date of the dissolution," under S. 38, the Bank was justified in paying to the partner (*Dickson* v. *National Bank of Scotland*, [1917]).

The rule as to good faith being essential as between partners applies to transactions undertaken after the partnership has been dissolved by the death of a partner, and before the affairs have been completely wound up. The continuing partners will, if profits are derived from carrying on the business for the purpose of winding up, in the absence of any special reason to the contrary, be entitled to some compensation for their services.

Where a premium has been paid for admission to the partnership there may, in the event of dissolution, be a claim by that partner to a return of the premium (S. 40). Where the partnership is at will, the partner paying the premium must be taken to have run the risk of the partnership being determined at any time, but if the partnership is for a fixed term and is dissolved before the end of the term, otherwise than by the death of the partner, the Court may in its discretion order the repayment of the premium or part of it. The rule usually adopted is to order a return of so much of the premium as bears the same proportion to the whole as the unexpired portion of the agreed term bears to the whole agreed term. A return will not be ordered where the misconduct of the partner paying the premium is the cause of dissolution. Where the partnership has been dissolved by an agreement not providing for a return of part of the premium, no order for the return will be made.

Conduct of the Winding Up.—The partners are the proper persons to get in the assets and wind up the affairs of the partnership, and their power to bind the firm continues for this purpose notwithstanding dissolution (S. 38). If after dissolution they cannot agree as to the winding up, the Court will appoint a receiver and, if necessary, a manager, and will on due occasion restrain a partner by injunction from doing any act which will impede the winding up, such as injuring the value of, or misapplying the assets of the firm. Where a partnership has been dissolved by the death or bankruptcy of one of the partners, the continuing or solvent partners are entitled to

wind up the affairs, and to an injunction restraining the executors or trustees in bankruptcy from interfering with them.

The Court will on proper grounds, at the instance of executors or trustees, protect the partnership assets and ensure the proper conduct of the winding up.

Application of the Partnership Property—Goodwill.—On dissolution every partner is entitled to have the partnership property applied in payment of the firm's debts and liabilities, and to have any surplus applied in payment of what may be due to the partners (S. 39).

This may involve the sale of the goodwill, which is a commercial rather than a legal expression. It has been described as " the benefit arising from connection and reputation," and as " the probability that the old customers will resort to the old place." The value is obviously greater in a business than a profession. A customer is likely to go to the same shop to buy the goods he has been accustomed to buy, whereas, in the case of a doctor or solicitor, the patient or client goes to his adviser because of his confidence in his skill. The relation is obviously less likely to be continued with the purchaser of the practice. Indeed, it has been said that in the business of solicitors goodwill in the ordinary sense hardly exists.

But whether the value be great or small, every partner has the right to have the goodwill sold, and the proceeds applied as part of the business assets. If this takes place, the purchaser alone may represent himself as continuing or succeeding to the business of the vendors. But any vendor, i.e. any partner, may carry on a similar competing business and advertise it, though he may not use the name of the old firm, or represent himself as continuing the old business, or canvass former customers of the old business. The purchaser may use the name of the old firm, but not so as to expose the partners to any liability; he must not represent any vendor as being still in the business.

Until the partnership affairs are wound up, the former partners must not carry on business in the firm name. After the winding up is complete every partner is free to use the firm name (unless the contrary has been agreed), but again not so as to expose a former partner to liability.

Where, after dissolution, the business of the partnership is carried on, without the capital of the outgoing partner being paid to him, and without any final settlement of accounts, then the outgoing partner, or his estate in the event of death, is entitled either to such a share of the profits made since the dissolution as is attributable to his capital, or to interest at 5 % on the amount of his share of the capital assets (S. 42). This clause does not apply where the partnership agreement gives to the continuing or surviving partner an option to purchase the share, and the option is exercised.

The amount due from surviving or continuing partners to an outgoing partner, or to his estate, is a debt. In the event of bankruptcy following dissolution the joint creditors whose debts existed at the dissolution must be paid first. But, subject to that rule, the status is changed, and the former partner has become a creditor.

When the assets have been got in they are, by S. 44, to be applied as follows :—

"In settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed :—

(*a*) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits.*

(*b*) The assets of the firm, including the sums, if any, contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order :—

(1) In paying the debts and liabilities of the firm to persons who are not partners therein.

(2) In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital.

(3) In paying to each partner rateably what is due from the firm to him in respect of capital.

(4) The ultimate residue, if any, shall be divided among the partners in the proportion in which profits are divisible."

In making out accounts on dissolution, it is usual to commence at the date of the last account settled by the partners. It has to be remembered that a practice recognised by the partners in taking accounts may apply only to accounts taken during the continuance of the partnership, and not to a dissolution account.

Administration of the Estate of Deceased Partner.—The surviving partners are creditors of the estate of a deceased partner for what may be found to be due to them on taking the partnership accounts. They may sue the legal representative of the deceased partner for a judgment for a partnership account and payment of what is due, and, if assets are not admitted, for administration of the estate of the deceased. Creditors of the partnership may also claim administration of the estate by the Court. But creditors of the firm are not entitled to be paid out of a deceased partner's estate until all his separate creditors have been satisfied. The rules in bankruptcy, that the debts of the firm are to be paid out of the assets of the firm, and the separate debts of each partner out of the separate estate, and that a partner may not prove against the separate estate of his

* See p. 210 as to the difficulties arising owing to the decision in *Garner* v. *Murray*.

co-partner while the joint debts are unpaid, have been adopted in administering the estate of a deceased partner.

Limited Partnerships.—Since 1907, partnerships of a special kind have been possible under the provisions of the *Limited Partnerships Act*, 1907. The object of the Act was, apparently, to legalise in this country special partnership arrangements corresponding to those existing in various foreign countries. The change in the law would probably have proved more popular if it had not happened to coincide with the *Companies Act*, 1907, under which private limited companies having only two shareholders were first allowed to be constituted.* But many limited partnerships have been registered under the terms of the Act.

Notwithstanding the provisions of the *Partnership Act*, 1890, a person lending money on the terms of taking a share of profits in a business was considered to run some risk of being held to be a partner. The *Limited Partnerships Act* is designed to avoid this danger. There may under that Act be a limited partnership, consisting of not more than ten partners in the case of a bank, or more than twenty in the case of any other business. One partner at least must be a general partner having the ordinary powers and liabilities of a partner, and one at least must be a limited partner. The partnership must be registered with the Registrar of Joint Stock Companies, together with particulars as to the general nature of the business, the firm name, the principal place of business, the names of the partners, the date of commencement and the term of the partnership, and the amount contributed by the limited partner, or each limited partner, if there be more than one, must be stated. Any changes that occur after registration must also be registered.

The general conduct of the business must be in the hands of the general partner or partners exclusively. The limited partner may inspect the books, examine into the state and prospects of the business, and advise the other partners thereon, but he must not take any part in the management of the business. He cannot bind the firm, nor may he withdraw any part of his capital. So long as he complies with these provisions, a limited partner is liable only to the extent of the capital subscribed by him. If he withdraws any part of his capital, he is liable, to the extent of the amount so withdrawn, for the firm's debts and obligations. If he takes part in the management of the business he becomes a general partner and liable as such for all debts and obligations incurred during the period in which he takes part in the management. The death or bankruptcy of a limited partner does not dissolve the firm; his capital vests in his personal representative, or trustee in bankruptcy. The general partner, or partners, alone decide questions arising in the ordinary course of business, and they may admit new partners without the consent

* See *Companies Act*, 1929, S. 1 [1] for authorisation now in force.

of the limited partner. On the other hand, the limited partner may assign his share (but only with the consent of the general partners), and his assignee becomes a limited partner in his place. The limited partner cannot dissolve the firm by notice. The effect of the Act is that a limited partner may safely invest money in a business and become entitled to a share of profits without any risk of being held to be a partner, and as such liable for the debts of the firm beyond the amount of his capital. The machinery of management is perhaps less cumbrous than in the case of a private company, but the latter device is generally preferred.

EXAMINATION QUESTIONS.

1. Give the definition of partnership as set out in S. 1 of the Partnership Act, 1890, and state what relations are expressly declared in that section not to be partnerships. Two executors carried on their testator's business, being so authorised by the will, under the same name as that in which he had carried it on. A receiving order was made against them in the firm name. State, giving reasons, whether or not you think the executors were liable to be adjudicated bankrupt as partners. (*Incorporated Accountants.*)

2. State in what particular features an ordinary partnership differs from a private company, and the latter from a public company. (*Chartered Accountants.*)

3. State whether a partnership exists in the following cases, giving your reasons: (*a*) Smith and Brown are joint owners of a landed estate, which they lease to tenants. (*b*) A lends B £500 for the purposes of B's business, in consideration of a share in the profits by way of interest. (*c*) White and Green were partners in a grocery business. On White's death, his widow agrees to leave his share of capital in the business in consideration of an annuity. (*Central Association Accountants.*)

4. Under what circumstances may a share of the profits of a business be paid to a person without constituting that person a partner? (*Chartered Accountants.*)

5. Briefly explain the extent to which a commercial firm may be bound by the acts of the members of the partnership. Enumerate a few financial transactions in the carrying out of which a partner has the implied authority to bind his co-partners. (*Chartered Accountants.*)

6. In respect of what matters, and how, may the ordinary authority and liability of a partner be modified or restricted as regards persons having dealings with the firm?

A, B, and C are partners in trade. C obtains for his sole benefit a renewal of the lease of the premises in which the partnership business is carried on. What are the rights of A and B in respect of the renewed lease?

Give reasons. (*Incorporated Accountants.*)

7. A. M. Khan & Co. issue a notice that they will not be bound by the acts of Lewis, who is one of the partners. Consider the effect of this notice as between the firm and persons dealing with it. (*Central Association Accountants.*)

8. Does the advance of money to a person engaged in business, by way of loan, at interest varying with the profits, make the lender a partner, and what is the lender's position if the borrower becomes insolvent? In what way has the Bankruptcy and Deeds of Arrangement Act, 1914, affected the law upon either of these points? (*Incorporated Accountants.*)

9. Summarise the acts by which a partner may bind his firm, and state to what extent, if at all, the partnership is liable for the torts of one of the partners. (*Incorporated Accountants.*)

10. "A partner, like a trustee, must not make a private gain by reason of his partnership in the firm." Illustrate this statement. On what general principle of law does it rest? (*Incorporated Accountants.*)

11. How may a new partner be admitted into a firm? (*Royal Society Arts.*)

12. What is the extent of the interest of a partner in the property of the firm? (*Royal Society Arts.*)

13. What powers has a partner of (*a*) engaging and (*b*) dismissing employees? (*Royal Society Arts.*)

14. What is the test, and the extent, of the general liability of partners for the debts of the firm, and how may it be limited in the case of (*a*) incoming partners and (*b*) retiring partners? (*Royal Society Arts.*)

15. What are the rights and duties of partners, as amongst themselves, with reference to signing cheques, rendering accounts, assigning a share of the partnership, carrying on another business, expelling a member of the partnership? (*Incorporated Accountants.*)

16. A and B, who, together with C, are carrying on business as agents for the sale of motor-cars and accessories, have discovered that C made a secret profit when selling a car in the name of the firm. Advise A and B as to their rights. (*Incorporated Accountants.*)

17. Explain the difference, if any, between the rights of partners in a trading concern to borrow money for business purposes as compared with the borrowing powers of the directors of a limited liability company. (*Chartered Accountants.*)

18. It is an implied term of every partnership agreement that each partner must observe the utmost good faith and fairness towards his fellow partners. Explain and illustrate this statement, and set out the provisions of the Partnership Act, 1890, which appear to you to be framed with the object of enforcing such implied terms. (*Incorporated Accountants.*)

19. A and B are partners. How far is A liable to C in respect of contracts made with C by B, or of torts committed against C by B? (*Royal Society Arts.*)

20. What is meant by the term "holding out" in relation to a partnership? How far is a person who holds himself out as a partner liable (*a*) for the debts owing by the firm; (*b*) for money misappropriated by a member of the firm? (*Incorporated Accountants.*)

21. What do you understand by the term "novation" as applied to partnerships? Explain fully what is necessary to constitute "novation." (*Chartered Accountants.*)

22. What is a partnership at will? How may such a partnership, and other partnerships, be determined? (*Incorporated Accountants.*)

23. Define goodwill, and say how it is to be dealt with on a dissolution of a firm. To what extent is the assignor of the goodwill bound not to enter into competition with the successors to the old firm? (*Incorporated Accountants.*)

24. What are the respective liabilities of (*a*) a partner, (*b*) a limited partner, (*c*) a dormant partner, (*d*) a retired partner for the debts incurred by the firm? (*Incorporated Accountants.*)

25. What obligations are imposed on firms by the Registration of Business Names Act, 1916 ? Does the law generally impose any restrictions as regards the name under which a firm may carry on business ? (*Central Association Accountants.*)

26. What authority is charged with carrying out the provisions of the Registration of Business Names Act, 1916, and how is it to deal with (*a*) misleading business names ; (*b*) the removal of names from the register ; (*c*) an alteration to be made in the particulars as to any firm, or peison, registered under the Act ? (*Incorporated Accountants.*)

27. Define a " firm " under the Registration of Business Names Act, 1916, and state in what manner registration thereof is to be effected, and what particulars are to be furnished for registration. (*Incorporated Accountants.*)

28. What are the rights of the partners in a trading concern : (*a*) As to borrowing money for the purposes of the business ; (*b*) as to interest upon capital ? (*Chartered Accountants.*)

29. What effect have the following upon the constitution of the firm : (*a*) Death of a partner ; (*b*) bankruptcy of a partner ; (*c*) assignment by a partner of his share ? (*Central Association Accountants.*)

30. What ought to be done to protect the interests of all parties (including creditors) : (*a*) When a new partner is admitted ? (*b*) when the firm is dissolved ?

Can anyone be held to be a partner in law without intending to be one ? (*Chartered Institute Secretaries.*)

31. In what circumstances is a partnership dissolved (*a*) without having recourse to the Court ; (*b*) by judicial proceedings ? (*Incorporated Accountants.*)

32. State the various grounds on which the Court will decree the dissolution of a partnership. What becomes of the goodwill of the firm on such dissolution ? (*Incorporated Accountants.*)

33. In settling the accounts between the partners after a dissolution of the partnership, what course must be adopted in distributing the assets of the firm ? (*Chartered Accountants.*)

34. Following upon a dissolution, how are the assets of a partnership to be applied, and what are included in such assets ? (*Incorporated Accountants.*)

35. You are to be appointed auditor under a partnership deed. The Draft Articles of Partneiship are sent to you for your opinion and approval of clauses affecting the accounts. What matters of account would you expect to be mentioned in the draft Articles, and state shortly the objects of the clauses ? (*Chartered Accountants.*)

36. Mention four clauses which you would expect to find in a deed of partnership, and state in each case the effect, if the deed is silent on that particular matter. (*Chartered Accountants.*)

37. A, B, and C were partners. C retired, and took no steps to free himself from partnership liabilities. His capital on retirement was £10,000. He received half in cash, and left the other half as a loan at a minimum rate of interest of 5 %, a higher rate on a sliding scale to be paid dependent on profits. The firm failed. The creditors whose claims existed when C retired amounted to £10,000, and there are claims subsequently contracted of £5,000. Do you consider C is liable for either or both classes of cieditors? Give reasons for your answer. (*Chartered Accountants.*)

38. Smith and Jones are proposing to enter into partnership as manufacturers. Smith is to provide £10,000 as capital and Jones £2,500. Jones is to manage the business and to devote the whole of his time to it. Smith is to devote to the business only so much of his time as he thinks fit.

You are requested to suggest such provisions, for inclusion in the partnership deed, with reference to the accounts and financial matters of the firm as, under the circumstances, you consider fair and right in the interests of both partners. (*Chartered Accountants.*)

39. Specify some of the circumstances which would enable the Court to decree the dissolution of a partnership upon the ground that it is "just and equitable." To what remedies is the defrauded partner entitled when he has been led into a partnership by misrepresentations? (*Incorporated Accountants.*)

40. How far can a partner's share and interest in a partnership be transferred (*a*) where he is a general partner; (*b*) where he is a limited partner? What is the transferee's position with regard to (*a*) the other partners; (*b*) the creditors of the firm? (*Incorporated Accountants.*)

41. Upon the sale of a partnership business as a going concern the partners obtained a substantial sum for goodwill. What is the nature of the money so obtained and how should it be dealt with when finally settling matters as between the partners? (*London Association Accountants.*)

42. In what ways may a partnership be dissolved, *otherwise than by* a decree of the Court? How must the assets be distributed upon a dissolution? (*Chartered Secretaries.*)

43. Mention briefly the distinctions (if any) between a sleeping partner and a limited partner. (*London Association Accountants.*)

44. What are the rights, if any, of a limited partner of access to, and investigation of, the accounts of the partnership and of management of the partnership business? (*Chartered Accountants.*)

45. In the relations of partners to one another what is their duty as to (*a*) rendering accounts, (*b*) accounting for private profits, and (*c*) competing with their own firm? (*Incorporated Accountants.*)

Chapter VII

PARTNERSHIP

II. Partnership Accounts.

The first thing to do when dealing with partnership accounts is to consider carefully the financial clauses of the partnership agreement. As we have seen, a properly prepared agreement will deal with (*a*) the period, yearly or half-yearly, which the accounts are to cover; (*b*) partners' capital; (*c*) partners' salaries, drawings, and interest on capital and drawings; (*d*) the proportion in which profits and losses are to be divided; (*e*) the basis of settlement on the death or retirement of a partner, or the dissolution of the firm; (*f*) goodwill, if any, and its treatment; (*g*) financial restrictions that may be imposed upon all or any of the partners.

If there is no partnership agreement, or if the agreement is silent upon any of the above matters, then the *Partnership Act*, 1890, will apply. Under that Act, as already stated, partners are :—

(i) Not entitled to make undisclosed profits out of the firm's business.

(ii) They must share profits and losses equally.

(iii) They are entitled to 5% per annum interest on loans, but

(iv) They are not entitled to interest on capital, or to a partnership salary.

There are no statutory books, nor is any system of book-keeping imposed in connection with partnership. The books suitable for a sole trader engaged in a similar business are equally suitable for a partnership. But, in partnership, certain accounts to record the financial relations of the partners as between themselves are imperative. The dates upon which accounts are to be made up, and the form in which they are to be prepared, are matters of mutual agreement between the partners. No creditor or other person has any statutory right to inspect the accounts of a partnership unless by consent of the partners, nor have any accounts or returns to be filed with any Government department.* But partnership firms are now usually required to produce accounts in support of their returns for assessment of Income Tax (Schedule D).

Capital and Current Accounts.—In the majority of cases, the

* Except that limited partnerships must be registered, and the regulations of the *Business Names Act* fulfilled, as explained in the previous chapter.

capital of a firm is contributed by more than one partner, and this fact must be recognised in the partnership books. The combined capitals of all the partners in a firm correspond to the single capital of a sole trader in that both capitals express and represent the excess of the assets of the business over its external liabilities. The proportion in which capital is contributed in no way affects the proportion in which profits and losses are shared, unless there be an agreement to the contrary.

If the provisions of the *Partnership Act*, 1890, are construed literally, capital contributed by partners is a *fixed* amount, and can be varied only by agreement; and, because losses automatically reduce the capital contributed, they should, in theory, be made good. In practice, however, losses are allowed to stand to the debit of the current account until they are wiped out by subsequent profits, or they are transferred to the debit of the capital account, as may be agreed. This procedure is, in effect, an adjustment of the original contributions of capital made when the accounts for a particular financial period have been prepared and agreed.

Students are sometimes perplexed by S. 24 of the Partnership Act, which states: "All the partners are entitled to share equally in the capital and profits of the business. . . ." This does *not* imply that if, for example, A and B are partners and contribute £10,000 and £1,000 respectively as capital, B is entitled to a half-share of A's capital, or, upon a dissolution, to half the assets of the partnership. The meaning is that, in the absence of an agreement to the contrary, profits or losses of capital are to be shared equally between A and B.

A separate capital account is opened for each partner, and this account is credited with the particular partner's capital contribution. For book-keeping purposes, the credit balances of these capital accounts are treated as a liability of the firm.

Drawings.—The majority of partnership agreements authorise the partners to withdraw from the business definite yearly sums in periodical instalments. These cash withdrawals are termed *drawings*. They are not withdrawals of capital, but are partial anticipations of the share of current profits to which each partner will become entitled when the firm's annual accounts have been prepared. During the currency of a financial year, drawings are treated as a debt due to the firm,* and are debited as described below. Normally, they are regarded as payments on account of profits accruing. But should a loss be made instead of a profit, or should the drawings exceed the profit made, then in the first case the whole of the sums drawn, and in the second the excess of the drawings, becomes a debt due to the firm, which, in theory, should be made good in order to preserve the capital intact. In practice, however, debits in respect of drawings are usually carried forward, for the time being at any rate, by mutual agreement between the partners.

* See *Elliott* v. *Elliott* at p. 215.

There are two methods of recording capital and drawings in the partnership books.

First Method.—Each partner is credited in his Capital Account with the amount of capital he has paid in, and also, at the close of the year, or other agreed accounting period, with (*a*) interest on capital at the agreed rate which, usually, is 5 % per annum; (*b*) his share of profits, if any; and (*c*) his partnership salary, if any. The Capital Account is debited with (i) all sums withdrawn by the partner as and when they occur, together with interest thereon at the agreed rate, which again is usually 5 % per annum; (ii) the partner's share of the loss, if any; and (iii) any goods of the firm which the partner may have withdrawn for his personal use during the period. Under this treatment the identity of the partner's original contribution of capital is soon lost.

Illustration.—H. Dickson and G. McArthur are trading in partnership as Dickson, McArthur & Co. From the details given below prepare the Capital Accounts of the partners as on December 31, 19..

H. Dickson, balance of Capital Account, January 1, 19.., £5,000.
G. McArthur, balance of Capital Account, January 1, 19.., £2,000.
H. Dickson, drawings: April 1st, £200; July 1st, £100; September 1st, £200.
G. McArthur, drawings: March 1st, £200; October 1st, £300. Goods withdrawn to December 31st, £17 6s. 8d.
Profits are divisible: two-thirds to H. Dickson and one-third to G. McArthur.
Interest at 5 % is allowed on Capital and charged on drawings. G. McArthur is entitled to a partnership salary of £150 per annum. The final net profit after adjustment for the Interest as above for the year was £1,875. [For solution, *see* pp. 140–1.]

Second method.—The more modern practice is to open two separate accounts for each partner, a Capital Account and a Current Account. By this method, each partner's capital is, in conformity with the Partnership Act, assumed to be a *fixed amount*, variable only as may be mutually agreed, as indeed actually is the case in many partnerships. In addition to the obvious advantage of keeping the Capital Account free from cumbersome detail, this practice is supported by several legal decisions, and is superseding the older method outlined above. The student will therefore be wise, when dealing with examination questions on partnership accounts, to adopt this modern method, unless it is clear from the opening position that the alternative method has been adopted in the past.

By the modern method, the Capital Account is confined to the amount of capital brought forward from the last financial period, adjusted as may be necessary to record capital sums subsequently brought in or withdrawn by mutual agreement. The Current (Drawings) Account is debited and credited with the same items mentioned in the first method. Interest on any loan made by a partner to the firm is also credited to the partner's Current Account.

Where a partner withdraws *goods* from the business, a personal account should be opened in the partner's name in the Sales Ledger to record the transaction, and the balance of this personal account should be transferred to the debit of the partner's account at the close

H. Dickson.

CAPITAL ACCOUNT.

Dr.

Date.	Particulars.	Folio.	Days.	Interest. £	s.	d.	Drawings, etc. £	s.	d.
19..									
April 1	To Cash	4	275	7	10	8	200	0	0
July 1	,, Cash	36	184	2	10	5	100	0	0
Sept. 1	,, Cash	72	122	3	6	10	200	0	0
Dec. 31	,, Interest	J. 41		13	7	11	13	7	11
,, 31	,, Balance carried down	√					5,986	12	1
						£	6,500	0	0

G. McArthur.

CAPITAL ACCOUNT.

Dr.

Date.	Particulars.	Folio.	Days.	Interest. £	s.	d.	Drawings, etc. £	s.	d.
19..									
Mar. 1	To Cash	2	306	8	7	8	200	0	0
Oct. 1	,, Cash	79	92	3	15	7	300	0	0
Dec. 31	,, Interest	J. 41		12	3	3	12	3	3
,, 31	,, Goods Account ..	S.L. 14					17	6	8
,, 31	,, Balance carried down	√					2,345	10	1
						£	2,875	0	0

of the financial period, and should not be included amongst sundry debtors. Usually, such drawings in kind are charged out to a partner at or slightly above cost price.

The credit balance of a partner's Current Account represents undrawn income from the business, and although a partner is not strictly entitled to interest on a credit balance unless the partnership

agreement provides for interest, yet usually interest is allowed at an agreed rate upon a credit balance until it is withdrawn, otherwise a partner whose Current Account was in credit would not be treated equitably. If a partner's Current Account shows a debit balance, the

H. Dickson.

CAPITAL ACCOUNT—*continued.*

Cr.

Date.	Particulars.	Folio.	Amount. £	s.	d.
19... Jan. 1	By Balance brought forward	P.L. 21	5,000	0	0
Dec. 31	,, Interest on Capital	J. 42	250	0	0
,, 31	,, Share of Profits for the year	P.L. 31	1,250	0	0
		£	6,500	0	0
19... Jan. 1	By Balance brought down	√	5,986	12	1

G. McArthur.

CAPITAL ACCOUNT—*continued.*

Cr.

Date.	Particulars.	Folio.	Amount. £	s.	d.
19... Jan. 1	By Balance brought forward	P.L. 27	2,000	0	0
Dec. 31	,, Interest on Capital	J. 42	100	0	0
,, 31	,, Share of Profits for the year	P.L. 31	625	0	0
,, 31	,, Partnership Salary	J. 28	150	0	0
		£	2,875	0	0
19... Dec. 31	By Balance brought down	√	2,345	10	1

balance should appear as a separate item on the assets side of the Balance Sheet as a debt due to the firm. Under some partnership agreements, interest is charged on a debit balance.

Illustration.—Take the particulars given in the example on p. 139 and prepare separate Capital and Current Accounts for H. Dickson and G. McArthur as on December 31, 19...

H. Dickson.

CAPITAL ACCOUNT—*continued.* CR.

			£	s.	d.
19... Dec. 31	By Balance brought forward	P.L. 21	5,000	0	0

H. Dickson.

CURRENT ACCOUNT—*continued.* CR.

Date.	Particulars.	Folio.	Amount.		
			£	s.	d.
19... Dec. 31	By Interest on Capital	J. 42	250	0	0
" 31	" Share of Profits for the year		1,250	0	0
		£	1,500	0	0
19... Dec. 31	By Balance brought down	√	986	12	1

G. McArthur.

CAPITAL ACCOUNT—*continued.* CR.

			£	s	d.
19... Dec. 31	By Balance brought forward	P.L 27	2,000	0	0

G. McArthur.

CURRENT ACCOUNT—*continued.* CR.

Date.	Particulars.	Folio.	Amount.		
			£	s.	d.
19... Dec. 31	By Interest on Capital	J. 42	100	0	0
" 31	" Share of Profits for the year	P.L. 31	625	0	0
" 31	" Partnership Salary	J. 28	150	0	0
			£875	0	0
19... Dec. 31	By Balance brought down	√	345	10	1

Partners' Loans.—Where the partnership deed mentions specific amounts as the capital of the partners, then, in the absence of any specific agreement to the contrary, any further sums paid in by partners are of the nature of loans. If no fixed capital has been arranged, it should be made clear in the partnership deed that additional payments in are to be treated as loans carrying interest. When a loan is advanced by a partner to the firm, a separate Loan Account should be opened for the partner, and a note should be made, as part of the heading of the account, stating the rate of interest payable and the terms of repayment, e.g. "Rate of Interest 6 % per annum. Loan repayable by annual instalments of £250 on the 1st of January in each year." We have already seen that, in the absence of agreement to the contrary, partners are entitled to interest at 5 % per annum on sums *advanced* by them to the firm as distinct from capital. But, notwithstanding this statutory right, it is advisable that the partnership agreement should clearly declare the method of treating loans and credit balances on current account, and the interest to be paid thereon. A partner cannot be charged with interest on any sums advanced *to* him by way of loan from the funds of the partnership unless it be so agreed. Under common law, loans do not carry interest, except by agreement or special custom.

In addition to the statutory regulations regarding specific loans, as described above, the student's attention should be directed to S. 24 (3) of the Act, which says: "A partner making, for the purposes of the partnership, any actual payment or advance beyond the amount of capital which he has agreed to subscribe, is entitled to interest at the rate of five per cent. per annum from the date of the payment in advance." Assume, by way of illustration, that A and B are partners. A has proceeded abroad, on the firm's business, and his return has been unexpectedly delayed, the firm's funds run short, and B is obliged to advance, from his private resources, £200 to meet wages and current needs. B is entitled to 5 % interest per annum on this £200.

Sleeping (Quasi) Partner.—It has already been stated that by *S*. 2, *ss*. (3), (*d*) a person may have "capital" in a business by way of a loan entitling him to receive in lieu of interest an agreed share of the profits without incurring the liabilities of an ordinary partner. Such "partners" take no active participation in the business, and are known as *sleeping* or *quasi* partners, although in effect they are deferred creditors, as such loans are not repayable until all outside liabilities have been satisfied. At the close of the financial period, the profits of the business having been ascertained, the share due to the sleeping partner should be debited in the appropriation section of the Profit and Loss Account in the ordinary way, credited to the Loan Account, and discharged by payment in due course.

Illustration.

GEORGE DICKSON, LOAN ACCOUNT.

ONE-TWELFTH OF PROFITS IN LIEU OF INTEREST.

DR.			£	s.	d.				£	s.	d. CR.
19... Feb. 5	To Cash	C.B.	465	0	0	19... Jan. 1	By Transfer from Capital Account	√	6,000	0	0
" 5	" Balance carried down	√	6,000	0	0	Dec. 31	" Share of Profits for the year ..		465	0	0
		£	6,465	0	0			£	6,465	0	0
						19... Feb. 5	By Balance brought down	√	6,000	0	0

Interest on Capital.—It has already been explained that interest on capital cannot be charged unless it has been specifically agreed that it should be charged. However, it is the general practice, under the *First Method* explained above, to credit partners with interest at an agreed rate, usually 5 % per annum, on their capital, or on the current balance of their capital accounts. This practice appears to confuse some students. But it should be borne in mind that this so-called " interest " is not interest which in the ordinary sense has been earned as such. It is a preliminary appropriation to the credit of the partners of a share of the firm's profits based upon the amount of their respective capitals, and is termed interest for convenience. A little thought will convince the student that an allowance ought to be made for interest in cases where the capital of the firm is contributed in a ratio other than that in which profits and losses are shared. Unless this is done, the rights of the partners *inter se* will not be adjusted equitably. Even in cases where the capital is equally held and profits are shared *pro rata*, it is usual and advisable to allow for interest on capital, in order that the partners may see what profit has been made by the business over and above the income which investment of the capital in outside securities would have produced.

Illustration 1.—The brothers George Dickson (Capital, £10,000) and Hugh Dickson (Capital, £3,000) are equal partners, and devote equal time and energy to the business. If no provision for interest on capital is made, George Dickson will contribute and risk £7,000 more capital than his brother, without any monetary compensation, although he could obtain, say, £350 per annum from outside investment of this sum. If 5 % interest on capital is allowed, the rights of the partners will be equitably adjusted.

Illustration 2.—J. McArthur and L. Pirrie are equal partners and have contributed £10,000 each as capital: No provision has been made for interest on capital. The profits of the firm for the year 19.. were stated in their Profit and Loss Account at £1,875. The partners could have safely invested their capital to produce, say, £900 per annum. The actual return for the time and work they have contributed and the trading risks they have incurred is therefore not £1,875 but £975. A provision for interest would, of course, make no difference to the ultimate income of

the partners, but it would call their attention to the actual return secured by risking their capital in trade, compared with the income they could have obtained from gilt-edged securities, their liability in the latter case being limited to the capital at stake, whereas, as traders, their liability is unlimited.

Illustration 3.—Dickson's capital is £5,000, and Chatenay's capital is £2,500. Profits are shared as to three-fifths to Dickson and two-fifths to Chatenay. The profit to be divided is £2,000. If no interest on capital is charged, Dickson will get £1,200 and Chatenay £800. If 5 % interest is charged, Dickson will get three-fifths of £1,625 + £250 interest = £1,225, and Chatenay will get two-fifths of £1,625 + £125 interest = £775. The discrepancy between the capitals of the two partners will thus be adjusted equitably.

It should be noted that interest on capital ceases from the date of a dissolution of partnership, notwithstanding the time occupied in disposing of the assets, or completing the winding up. In the absence of agreement to the contrary, the same rule applies to partnership salaries.

The interest on capital credited to the partners' accounts is clearly an appropriation of the profits of the firm. In actual practice it is common to make *direct transfers* of the interest allowed from the credit of the respective Current Accounts to the debit of the Interest on Capital Account. Strictly speaking, a Journal Entry should be passed through the books as follows:—

JOURNAL.

			DR			CR.		
		P.L.	£	s.	d.	£	s.	d.
19... Dec. 31	Interest on Capital Account .. .. Dr.	71	1,050	0	0			
	To G. McArthur	16				500	0	0
	„ W. F. Dreer	21				350	0	0
	„ B. Uprichard	32				200	0	0
	For interest on capital at 5 % per annum for the year ended December 31, 19...							

At the close of each financial period the total balance of the Interest Account is transferred to the debit of Profit and Loss Account (preferably Appropriation Section).

Interest on Drawings.—Where drawings take place of amounts in the same ratio as that in which partners share profits and losses at fixed intervals, no particular advantage is gained by charging interest on the amounts drawn. But the need for the charge is clear where the drawings of the partners are not in this ratio or are irregular in date. Interest runs from the date of the drawing to the close of the financial period, and is usually at the rate of 5 % per annum. The common practice is to provide two extra columns on the debit side of the partners' Current Accounts to accommodate (*a*) the number of days, and (*b*) the amount of interest on each drawing, as shown in the current accounts on p. 142. Theoretically, when these debits are made, corresponding entries should be passed to the credit of Interest on Drawings Account. But in practice the debits are collected at the close of the financial period in one journal entry as follows:—

JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
19... Dec. 31	Sundries :— Dr.	P.L.						
	G. McArthur	27	36	2	4			
	W. F. Dreer	32	21	1	8			
	B. Uprichard	41	12	17	6			
	To Interest on Drawings Account	76				70	1	6
	For interest at 5 % per annum on partners' drawings for the year ended December 31, 19...							

Illustration.—Abel Chatenay and Alfred Colomb are partners who have contributed capital equally, and share profits equally. There is no agreement concerning drawings, or for charging interest thereon. During the year 19.., Chatenay's drawings were: July 1st, £200 ; December 1st, £200. Colomb's drawings were : March 1st, £300 ; May 1st, £200 ; July 1st, £300 ; October 1st, £200 ; December 1st, £400. Chatenay therefore withdrew £400 and Colomb £1,400. It is to be presumed that the difference of £1,000 could have been employed profitably in the business. Certainly it could have been invested safely and earned interest ; indeed, Colomb could have invested the £1,000 to his own profit. Unless, therefore, interest is charged on the drawings, Colomb will benefit at the expense of Chatenay.

It should not be necessary to remind students of advanced bookkeeping that partners' drawings are in no sense a *charge* against profits. They are merely instalments paid on account of profits which are assumed to be accruing to the business. If that assumption proves incorrect, then drawings in excess of the ascertained profits are debts due to the firm. These remarks are here obtruded, because, in the author's experience, some candidates make the serious error of principle of debiting drawings to the Profit and Loss Account when answering examination questions.

In practice, direct entries are usually made, debiting Interest on Capital Account, and crediting the partners' Current Accounts with interest due on capital, and crediting Interest on Drawings Account and debiting Current Accounts with interest on drawings. If Journal entries are made, as from an academic point of view they should be made, they would appear as shown on p. 148.

Partnership Salaries.—It has already been explained that partners are not entitled, as a matter of right, to a partnership salary, no matter what services they may render to the partnership business. But in some partnerships, one (or more) of the partners may devote more time, or greater technical skill and experience, to the business than the other partners. It is usual to recognise this greater devotion or skill by means of a partnership salary, paid or credited to the partner (or partners) concerned. Junior partners frequently receive a fixed salary, and a small share only of the profits. Such salaries are charged against profits prior to division If partnership salaries are paid in cash at agreed intervals, they may be posted direct from the Cash Book to the debit of Partnership Salaries Account. But, under most agreements, the more usual method is to credit the partners' Current Accounts at

the close of the financial period with the salaries due, and to debit Profit and Loss Account with the same amounts. In practice, the

JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
19... Dec. 31	Interest on Capital Account .. .. Dr.	P.L. 16	750	0	0			
	To A. Dickson, Current Account	41				500	0	0
	,, B. Morse, Current Account	52				250	0	0
	For interest on capital at 5 % for the year ended this day.							
,, 31	Sundries :— Dr.							
	A. Dickson, Current Account	42	56	18	6			
	B. Morse, Current Account	53	21	9	4			
	To Interest on Drawings Account	17				78	7	10
	For interest at 5 % on drawings during the year.							
,, 31	B. Morse, Current Account .. .. Dr.	53	31	14	5			
	To B. Morse, Goods Account	S.L. 147				31	14	5
	For balance transferred, being goods supplied during the year.							
,, 31	Interest Account .. .. Dr.	P.L. 16	100	0	0			
	To A. Dickson, Current Account	41				100	0	0
	For interest at 5 % for the year on loan of £2,000.							

transfers are usually made direct, but, theoretically, journal entries should be made. Where a partnership salary is one of the adjustments required by the terms of an examination question, the necessary entry is :—

JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
19... Dec. 31	Profit and Loss Account .. .. Dr.	P.L. 87	500	0	0			
	To G. McArthur, Current Account	32				500	0	0
	For partnership salary for the year ended December 31, 19...							

In the absence of a note as shown above in Journal form, examination candidates usually make the Profit and Loss charge correctly, but are apt to overlook the compensating entry in the current account as set out in the Balance Sheet.

Illustration.—A. Chatenay and T. Testout each contribute £5,000 as capital and share profits equally. Chatenay owns and works a farm and devotes but three days a week to the partnership business. Testout gives his whole time to the business. It was agreed that, prior to the division of profits, Testout should be credited with £450 per annum as a partnership salary. The profits of the firm, after providing for all charges except Testout's salary, were £3,264. Interest is allowed on capital and charged on drawings at 5 % per annum. Testout's drawings were £968 and the charge for interest thereon was £23 6s. 8d. On January 1, 19.., the credit balance of Testout's Current Account was £76 10s. 5d. Prepare the final section of the firm's Profit and Loss Account, and Testout's Current Account as it would appear in the firm's Balance Sheet on December 31, 19...

Chatenay & Testout.

PROFIT AND LOSS ACCOUNT (FINAL SECTION) FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.		£	s.	d.	Cr.	£	s.	d.
To Partnership Salary		450	0	0	By Balance brought down	3,264	0	0
" A. Chatenay, Half-share of Profits	£1,407							
" T. Testout, Half-share of Profits	1,407							
		2,814	0	0				
	£	3,264	0	0	£	3,264	0	0

Note.—The Interest on Capital and Drawings should also appear in the Final Section, but the question indicates that these have been adjusted in the earlier section of the Profit and Loss Account.

BALANCE SHEET, DECEMBER 31, 19...

(Liabilities Side Only.)

				£	s.	d.	£	s.	d.
Capital :—									
A. Chatenay				5,000	0	0			
T. Testout				5,000	0	0			
							10,000	0	0
Current Account :—									
T. Testout :									
Balance, December 31, 19..				76	10	5			
Interest on Capital				250	0	0			
Partnership Salary				450	0	0			
Share of Profits				1,407	0	0			
				2,183	10	5			
Less Drawings	£968	0	0						
Interest thereon	23	6	8						
				991	6	8			
							1,192	3	9

If, in the illustration given on p. 148, the capital of the partners was not "fixed" in amount, Testout's Capital Account would be set out in the Balance Sheet as follows :—

BALANCE SHEET.

(Liabilities Side Only.)

				£	s.	d.	£	s.	d.
Capital :—									
T. Testout :									
As per last Balance Sheet				5,076	10	5			
Interest on Capital				250	0	0			
Partnership Salary				450	0	0			
Share of Profits for the year				1,407	0	0			
				7,183	10	5			
Less Drawings	£968	0	0						
Interest thereon	23	6	8						
				991	6	8			
							6,192	3	9

Losses.—Losses must, of course, be debited in the agreed proportions to the partners' Current Accounts, and the final balances of these accounts, if in debit, must be set out on the Assets side of the firm's Balance Sheet. Unless the partnership articles otherwise stipulate, or further working capital is required, partners, in practice, do not make good a shrinkage in the original capital contributed by them, except, as explained later, in the event of dissolution. It is usual, however, for the Articles to provide that interest at a rate agreed shall be charged on the debit balances of Current Accounts until made good. If this is not done, partners whose Current Accounts remain in credit are not equitably treated.

Examination candidates are advised to prepare a partnership Profit and Loss Account in two sections. The *first* section will show the detailed charges to be met out of the gross profit brought from the Trading Account. The resulting balance, representing the net profit or loss divisible between the partners, will be carried to the *second* section, in which the division of the balance will be shown. By this method, the net result of the year's trading appears clearly as a *separate figure*, and is quickly available when the information is required, or comparisons with former years have to be made. Moreover, this method saves the time of the examiner! The practice frequently adopted by candidates of completing the debit side of the Profit and Loss Account by entries representing the share of profits due to the partners is not, of course, inaccurate, but it is out of harmony with usual business practice, and it compels an examiner to work an addition sum in order to secure the information he seeks!

Sometimes, partnership Profit and Loss Accounts are prepared in *three* sections. Section I shows the actual net trading result; Section II the details of interest on capital and on drawings, partnership salaries, and other similar partnership adjustments; Section III, the division of the resulting balance between the partners. This method facilitates the preparation of Income Tax returns, and shows the trading results at a glance as distinct from mere partnership allocations.

Illustration.—George, Hugh, and Robert Dickson trade as Dickson Brothers. Profits are divided: one-half to George, and one-quarter each to Hugh and Robert. Interest at 5 % is allowed on capital and charged on drawings. The capital is fixed, and is held as follows: George, £10,000; Hugh, £5,000; Robert, £3,000. At the close of each year a partnership salary of £300 is to be credited to Hugh, and one of £200 to Robert. The following balances appeared in the Trial Balance of the firm on December 31, 19..: Trading Account (Credit Balance), £14,299; Office Salaries, £2,371; Office Expenses, £214; Reserve for Bad Debts, January 1, 19.., £320; Sundry Debtors, £8,440; Discount Account (Credit Balance), £37; Office Furniture, £740; Machinery and Plant, £3,460; Office Rent, Rates, Heating, Lighting, £942; Loan at 5 % per annum from George Dickson, £2,000; Travellers' Salaries and Commission, £3,270; Carriage Outwards, £374; Advertising, £845; Bank Interest and Charges, £159; Bad Debts, £277. Partners' drawings: George, £1,250 interest thereon, £29; Hugh,

Dickson Brothers.

DR. PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19... CR.

		£	s.	d.		£	s.	d.
To Depreciation of Machinery and Plant *		519	0	0	By Balance from Trading Account	14,299	0	0
,, Balance carried down, being gross profit		13,780	0	0				
	£	14,299	0	0	£	14,299	0	0
To Rent, Rates, and Heating		942	0	0	By Balance brought down	13,780	0	0
,, Office Salaries		2,371	0	0	,, Discounts (net)	37	0	0
,, Office Expenses		214	0	0				
,, Depreciation (Office Furniture)		37	0	0				
,, Advertising		845	0	0				
,, Travellers' Salaries and Commission		3,270	0	0				
,, Carriage Outwards		374	0	0				
,, Bad Debts written off		277	0	0				
,, Reserve for Doubtful Debts :—								
December 31, 19..	£422 0 0							
Less January 1, 19..	320 0 0							
		102	0	0				
,, Bank Interest and Charges		159	0	0				
,, Balance carried down, being net profit for year		5,226	0	0				
	£	13,817	0	0	£	13,817	0	0
To Interest on Loan (Geo. Dickson)		100	0	0	By Balance brought down	5,226	0	0
,, Partnership Salaries :—					,, Interest on Drawings	70	0	0
Hugh Dickson	£300 0 0							
Robert Dickson	200 0 0							
		500	0	0				
,, Interest on Capital :—								
George Dickson	£500 0 0							
Hugh Dickson	250 0 0							
Robert Dickson	150 0 0							
		900	0	0				
,, Balance carried down, being divisible profit for the year		3,796	0	0				
	£	5,296	0	0	£	5,296	0	0
To George Dickson, ½ Share of Profits	£1,898 0 0				By Balance brought down	3,796	0	0
,, Hugh Dickson, ¼ Share of Profits	949 0 0							
,, Robert Dickson, ¼ Share of Profits	949 0 0							
		3,796	0	0				
		£3,796	0	0		£3,796	0	0

* In practice, all depreciations are frequently dealt with in the Profit and Loss Account. Strictly speaking, in a manufacturing business depreciation on Machinery and Loose Tools is a part of the manufacturing cost, and should appear in the Manufacturing Account. In view of the diversity of practice, however, either treatment would probably be equally marked in examination work.

Dickson Brothers.

BALANCE SHEET, DECEMBER 31, 19..

(PARTNERS' ACCOUNTS ONLY.)

		£	s.	d.	£	s.	d.
Capital :—							
George Dickson		10,000	0	0			
Hugh Dickson		5,000	0	0			
Robert Dickson		3,000	0	0	18,000	0	0
Current Accounts :—							
George Dickson :							
As on January 1, 19.. ..		949	0	0			
Interest on Loan		100	0	0			
Interest on Capital		500	0	0			
Profit for the year		1,898	0	0			
		3.447	0	0			
Less Drawings ..	£1,250						
Interest thereon	29	1,279	0	0	2,168	0	0
Hugh Dickson :							
As on January 1, 19..		227	0	0			
Partnership Salary		300	0	0			
Interest on Capital		250	0	0			
Profit for the year		949	0	0			
		1,726	0	0			
Less Drawings ..	£872						
Interest thereon	19	891	0	0	835	0	0
Loan Account :—							
George Dickson					2,000	0	0

		£	s.	d.	£	s.	d.
Current Account :—							
Robert Dickson :							
As on January 1, 19.. ..		319	0	0			
Drawings		985	0	0			
Interest thereon		22	0	0			
Goods Account		79	0	0			
	£	1,405	0	0			
Less Partnership Salary ..	£200						
Interest on Capital	150						
Profit for the year ..	949	1,299	0	0	106	0	0

£872, interest thereon, £19; Robert, £985, interest thereon, £22. Partners' Current Accounts on January 1, 19..: Credit Balances, George, £949; Hugh, £227; Debit Balance, Robert, £319. Robert Dickson, for goods had, debit balance, £79. A reserve for bad debts equal to 5 % on the Sundry Debtors is to be made. Depreciation is to be provided as follows: Machinery and Plant, 15 % per annum; Office Furniture, 5 % per annum. The interest at 5 % per annum on George Dickson's loan must be provided for. Prepare the firm's Profit and Loss Account for the year ended December 31, 19.., and show the position of the partners as it would appear in the Balance Sheet at the same date.

EXAMINATION QUESTION.

On December 31, 19.., three partners had the following amounts at the credit of their Capital Accounts: A, £5,000; B, £3,000; C, £2,000.

On January 1st previous, they had to the credit of their Drawing Accounts: A, £750; B, £500; C, £400.

Profits are divided in the same proportion as the capital, up to £2,000. Above that amount, A gets 25 %, B 35 %, and C 40 %.

A drew during the year 19.., £500; B drew during the year 19.., £400; C drew during the year 19.., £300.

The profits for 19.. amounted to £3,000, before charging interest on capital (to which all are entitled) at 4 %.

Give the Drawing Account of each partner on December 31, 19.., interest on drawings to be ignored. (*Chartered Accountants—Intermediate.*)

A. DRAWINGS ACCOUNT.

Dr. | Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Cash		500	0	0	Jan. 1	By Balance		750	0	0
" 31	" Balance carried down		1,600	0	0	Dec. 31	" Interest on Capital		200	0	0
						" 31	" Share of Profits ..		1,150	0	0
		£	2,100	0	0			£	2,100	0	0
						19...					
						Dec. 31	By Balance brought down		1,600	0	0

B. DRAWINGS ACCOUNT.

Dr. | Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Cash		400	0	0	Jan. 1	By Balance		500	0	0
" 31	" Balance carried down		1,030	0	0	Dec. 31	" Interest on Capital		120	0	0
						" 31	" Share of Profits ..		810	0	0
		£	1,430	0	0			£	1,430	0	0
						19...					
						Dec. 31	By Balance brought down		1,030	0	0

C. DRAWINGS ACCOUNT.

Dr. Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Cash		300	0	0	Jan. 1	By Balance		400	0	0
" 31	" Balance carried down		820	0	0	Dec. 31	" Interest on Capital		80	0	0
						" 31	" Share of Profits ..		640	0	0
		£	1,120	0	0			£	1,120	0	0
						19...					
						Dec. 31	By Balance brought down		820	0	0

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr. Cr.

			£	s.	d.			£	s.	d.
To Interest on Capital :—						By Balance brought down		3,000	0	0
A	£200									
B	120									
C	80									
			400	0	0					
" Balance carried down			2,600	0	0					
		£	3,000	0	0		£	3,000	0	0
To A : $\frac{5}{10}$ of £2,000	£1,000					By Balance brought down		2,600	0	0
25 % of Balance ..	150									
			1,150	0	0					
" B : $\frac{3}{10}$ of £2,000	600									
35 % of Balance ..	210									
			810	0	0					
" C : $\frac{2}{10}$ of £2,000	400									
40 % of Balance ..	240									
			640	0	0					
		£	2,600	0	0		£	2,600	0	0

Portion of Junior Partner's Share Borne by Another.—Not infrequently in practice, a junior partner is admitted on the understanding that the whole or a portion of his share of the profits and partnership salary is to be borne by a senior partner. The sons of senior partners are sometimes introduced into the firm on some such arrangement. Such agreements involve no book-keeping difficulties, but they seem to confuse some students when confronted with them in examination questions.

Illustration 1.—George Dickson and G. McArthur are equal partners. They agree to admit Dickson's son, Hugh, as a partner on January 1, 19.., and allow him one-ninth share of the profits, such share to be borne by George Dickson. For the year ended December 31, 19.., the profits were £8,649. The division of profits would be as follows :—

Dickson & McArthur.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

(APPROPRIATION SECTION.)

DR.		£	s.	d.	CR.	£	s.	d.
To George Dickson :— Share of Profits £4324 10 0 *Less* Transfer to Hugh Dickson 961 0 0		3,363	10	0	By Balance brought down.. ..	8,649	0	0
,, G. McArthur, Share of Profits ..		4,324	10	0				
,, Hugh Dickson, Share of Profits..		961	0	0				
	£	8,649	0	0	£	8,649	0	0

Illustration 2.—Dickson and Chatenay, equal partners, admit McArthur as junior partner. The capital, bearing interest at 5 %, is held as follows: Dickson, £10,000; Chatenay, £8,000. McArthur is to pay in £2,000 as capital. Salaries are to be credited as follows: Chatenay, £450; McArthur, £300. McArthur is to have one-eighth of the profits, but as Dickson is to be relieved of regular attendance at the office, it is agreed that as between Dickson and Chatenay one-half of McArthur's share of the profits and £200 of his salary is to be borne by Dickson.

Dickson, Chatenay & McArthur.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

DR.		£	s.	d.	CR.	£	s.	d.
To Interest on Capital :— Dickson .. .. £500 0 0; Chatenay .. .. 400 0 0; McArthur 100 0 0		1,000	0	0	By Balance brought down	9,830	0	0
Partnership Salaries :— Chatenay .. .. £450 0 0; McArthur 300 0 0		750	0	0				
,, McArthur ⅛ of Balance		1,010	0	0				
,, Balance carried down		7,070	0	0				
	£	9,830	0	0	£	9,830	0	0
To Dickson		3,887	10	0	By Balance brought down	7,070	0	0
,, Chatenay		3,887	10	0	,, Dickson: ½ of McArthur's share .. .. £505 0 0; McArthur's salary 200 0 0	705	0	0
	£	7,775	0	0	£	7,775	0	0

DICKSON'S CURRENT ACCOUNT

	£	s.	d.		£	s.	d.
To P. & L. Account	705	0	0	By P. & L. account	3,887	10	0
,, Balance carried down	3,182	10	0				
	3,887	10	0		3,887	10	0
				,, Balance brought down	3,182	10	0

Sometimes a junior partner is admitted to a firm on the basis of a small share of the profits, accompanied by a senior partner's guarantee

that the share of profits shall not be less than a named sum. Assume, for example, that A and B admit C to partnership with one-tenth share of the profits, A guaranteeing that C's share of profits shall not be less than £1,000 in any one year. If C's share of the profits at the close of any one year, amounted to, say, £875 only, then £125 must be debited to A's Current Account and credited to C's Current Account to transfer the amount. In the Appropriation Account, C will be credited with £875 only. If the minimum amount has been guaranteed by the firm, and not by an individual partner, the sum required to make up the guaranteed amount must be deducted from the shares of the other partners in the proportion in which they share profits.

Illustration.—A and B are partners. They admit C as a partner on the understanding that his share of the profits shall not be less than £1,200 in any one year. Profits are shared in the proportion one-half to A, three-eighths to B, one-eighth to C. The profits for the year ended December 31, 19.., were £7,800. The division of profits would be as follows :—

A, B & C.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

(APPROPRIATION SECTION.)

Dr.				£	s.	d.	Cr.	£	s.	d.
To A, Share of Profits..	£3,900	0	0				By Balance brought down	7,800	0	0
*Less Transfer to C, 4/7 of £225	128	11	5	3,771	8	7				
,, B, Share of Profits .	2,925	0	0							
*Less Transfer to C, 3/7 of £225	96	8	7	2,828	11	5				
,, C, Share of Profits..	975	0	0							
*Add Transfer from A	128	11	5							
Transfer from B	96	8	7	1,200	0	0				
			£	7,800	0	0	£	7,800	0	0

* These transfers can be made direct between the partners' current accounts, as explained above.

Where there is agreement between two or more partners for partnership salaries, the position is somewhat more complicated when the profits available are insufficient to meet partnership salaries and interest on capital.

Illustration.—Dickson, Chatenay, and Uprichard are partners. Capital bears 5 % interest and is held as follows : Dickson, £6,000 ; Chatenay, £5,000. Dickson and Chatenay are equal partners. Uprichard, Dickson's nephew, was admitted to partnership on the terms that he was to be paid £300 as a partnership salary, £100 of which is to be borne by Dickson, and one-seventh of the profits, also to be borne by Dickson. Dickson and Chatenay each take half of the profits. For the year ended December 31, 19.., the profits were £430. The Profit and Loss Account and the partners' Current Accounts would appear as follows :—

Dickson, Chatenay & Uprichard.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
To Partnership Salary (Uprichard)	200	0	0	By Balance brought down	430	0	0
,, Interest on Capital*:—				,, Dickson, Share of Loss	160	0	0
Dickson £300				,, Chatenay, Share of Loss	160	0	0
Chatenay 250							
	550	0	0				
	£750	0	0		£750	0	0

DICKSON. CURRENT ACCOUNT.

Dr. 19...		£	s.	d.	19...	Cr.	£	s.	d.
Dec. 31	To Transfer, U's Salary	100	0	0	Dec. 31	By Interest on Capital..	300	0	0
,, 31	,, Share of Loss ..	160	0	0	,, 31	,, Transfer, U's ½ Share of Loss of £320 ..	45	14	3
,, 31	,, Balance carried down	85	14	3					
		£345	14	3			£345	14	3
					19... Jan. 1	By Balance brought down	85	14	3

CHATENAY CURRENT ACCOUNT.

Dr. 19...		£	s.	d.	19...	Cr.	£	s.	d.
Dec. 31	To Share of Loss ..	160	0	0	Dec. 31	By Interest on Capital..	250	0	0
,, 31	,, Balance carried down	90	0	0					
		£250	0	0			£250	0	0
					19... Jan. 1	By Balance brought down	90	0	0

UPRICHARD. CURRENT ACCOUNT.

Dr. 19...		£	s.	d.	19...	Cr.	£	s.	d.
Dec. 31	To Transfer from Dickson, Share of Loss..	45	14	3	Dec. 31	By Partnership Salary ..	200	0	0
,, 31	,, Balance carried down	254	5	9	,, 31	,, Transfer Salary from Dickson	100	0	0
		£300	0	0			£300	0	0
					19... Jan. 1	By Balance brought down	254	5	9

* In the above illustration it is assumed that, as is usual in practice, the agreement provides that interest on Capital is to be credited even when profits are insufficient to meet it. In the absence of such agreement, interest would be "abated" in proportion to Capital in order to adjust it to the amount of profits available to meet it, in view of the provisions of S. 24 [4], Partnership Act, 1890 (see p. 124).

This illustration should be compared with that on p. 155; in the latter the agreement for the adjustments was between Dickson and Chatenay only, whereas in the above illustration the agreement is between *all* the partners, hence the different treatment in the books.

Goodwill in a Partnership.—Goodwill in its general aspect has been considered at pp. 85–88. In this place, we deal with the asset as and when it may occur in a partnership. Goodwill does not appear in the vast majority of partnership accounts. But certain events

may compel the assessment of this asset. These are: (*a*) dissolution of partnership; (*b*) the death or retirement of a partner; (*c*) the admission of a new partner; and (*d*), often overlooked in practice, a change in the Profit and Loss sharing ratio. Probably, the majority of present-day partnership agreements define the basis upon which in case of need goodwill is to be valued. The student will understand the need for making an adjustment for goodwill in partnership accounts, when he reflects that upon the happening of any of the events (*a*), (*b*), (*c*) mentioned above, a *new firm* is brought into being.

For example, A and B, equal partners, have traded as A, B & Co. for fifteen years, and built up a prosperous business yielding an average profit of £5,000 per annum. To cope with increasing trade, they admit C to partnership; who, although he has done nothing to create the goodwill obviously attaching to the business, would be entitled to his proportionate share of the profits derived from the goodwill, and to a share in the value of that asset should dissolution or death occur. In order, therefore, that the claims of the old partners who built up the goodwill may be dealt with equitably, it is decided to compensate them by creating a Goodwill Account, and to credit each of them with £5,000, being two years' average profits.

Consider a somewhat extreme case by way of further illustration of the need for taking goodwill into account on the admission of a new partner. A and B admit C to partnership on the terms that he is to pay in £3,000 as capital and to have one-fifth of the profits. Goodwill is not taken into account. Unforeseen circumstances arise, and the business has to be sold three months after C's admission. The goodwill realises £5,000. C is thus entitled to his share of this paper profit of £5,000, notwithstanding that he had no part in creating the goodwill.

Again, D, E, & F have together built up a prosperous business. If D should die, would it be equitable that E and F should succeed to the whole of the goodwill to the exclusion of the representatives of D who presumably took a prominent part in its foundation?

Admission of New Partner.—The admission of a new partner is the most common occasion for the creation of a goodwill account in partnership books.

Illustration.—A and B are partners in an old-established business. The Balance Sheet of the firm at December 31, 19.., was as follows:—

A & B.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Sundry Assets	18,700	0	0
A	£10,000				Cash at Bank	1,985	0	0
B	8,000							
		18,000	0	0				
Creditors..		2,685	0	0				
	£	20,685	0	0	£	20,685	0	0

On January 1, 19.., it is agreed to admit C to partnership, who is to provide £4,000 as capital and to pay A and B £1,000 by way of premium for a quarter share of profits. C's cash resources do not, however, exceed £4,000, and he pays this in as capital. In lieu of the premium otherwise payable in cash, it is agreed that a Goodwill Account of £4,000 should be created, and a similar amount should be credited to A and B in the same proportion in which they share profits. The old partners thus surrender their claim for the cash premium, and become creditors of the firm for their respective shares of the goodwill credited to their Capital Accounts, and also benefit from the interest accruing on the additional capital standing to their credit. The Balance Sheet of the new firm would appear as follows:—

A, B & C.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.		£	s.	d.
Capital:—					Goodwill	4,000	0	0
A	£12,000				Sundry Assets	18,700	0	0
B	10,000				Cash at Bank	5,985	0	0
C	4,000							
		26,000	0	0				
Creditors		2,685	0	0				
	£	28,685	0	0	£	28,685	0	0

Premium for Admission of New Partner.—Frequently, the claims of the founders of a partnership goodwill are recognised by a new partner paying an agreed sum in cash as a premium for his admission to the firm and a share of its goodwill. There is no need, in such cases, to open a goodwill account in the books, or to make any entries whatever. The transaction is a *private* one between the old partners and the new partner, and does not affect the financial position of the firm. But the partners may desire to have a record of the transaction in the books of the new firm, and this could be done in the manner shown below, or by means of the alternative entries given in the illustration at p. 160.

Illustration.—A and B are equal partners. They admit C to partnership as on January 1, 19.., on the terms that he is to pay £2,000 premium for his admission and to introduce £3,000 as capital.

1 CASH BOOK. 1

Dr. Cr.

				£	s.	d.				£	s.	d.
19...												
Jan. 1	To C, Cash:—											
	Capital ..	£3,000	3									
	Goodwill ..	2,000	2									
				5,000	0	0						

GOODWILL ACCOUNT. 2

Dr. Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Jan. 1	To Transfer:—					Jan. 1	By Cash (C)	1	2,000	0	0
	A's Capital Account	4	1,000	0	0						
	B's Capital Account	5	1,000	0	0						

C. CAPITAL ACCOUNT.

3 Dr. — Cr. 3

			£	s.	d.	19...			£	s.	d
						Jan. 1	By Cash	1	3,000	0	0

A. CAPITAL ACCOUNT.

4 Dr. — Cr. 4

			£	s.	d.	19...			£	s.	d.
						Jan. 1	By Balance	√	5,000	0	0
						„ 1	„ Goodwill Account	2	1,000	0	0
								£	6,000	0	0

B. CAPITAL ACCOUNT.

5 Dr. — Cr 5

			£	s.	d.	19...			£	s.	d.
						Jan. 1	By Balance..	√	5,000	0	0
						„ 1	„ Goodwill Account	2	1,000	0	0
								£	6,000	0	0

Illustration.—B. Black and W. White are partners and share profits and losses as to two-thirds to Black and one-third to White. Black contributed £10,000 capital, and White £7,500. They admit G. Green to partnership, who is to pay in £5,000 as capital and £3,000 by way of premium for admission. Green stipulates that the premium shall be left in the business in order to strengthen the firm's financial position. The necessary entries are as follows :—

Black & White.

CASH BOOK.

32 Dr. — Cr. 32

		P.L.	£	s.	d.				£	s.	d.
	To Green :—										
	Capital .. £5,000	3									
	Premium.. 3,000	1, 2									
			8,000	0	0						

PRIVATE LEDGER.

B. Black. Capital Account. 1

Dr. — Cr.

			£	s.	d.				£	s.	d.
							By Balance	√	10,000	0	0
							„ $\frac{2}{3}$ Premium from Green	C.B. 32	2,000	0	0
								£	12,000	0	0

PRIVATE LEDGER—*continued.*

2 W. WHITE. CAPITAL ACCOUNT. 2

Dr.			£	s.	d.	Cr.			£	s.	d.
							By Balance	√	7,500	0	0
							„ ⅓ Premium from Green	C.B. 32	1,000	0	0
								£	8,500	0	0

3 G. GREEN. CAPITAL ACCOUNT. 3

Dr.			£	s.	d.	Cr.			£	s.	d.
							By Cash		5,000	0	0

If no agreement was made regarding the retention of the premium in the business, but there was a desire to record the payment of the premium in the books of the firm, the only entries would be :—

CASH BOOK.

Dr.			£	s.	d.	Cr.			£	s.	d.
	To Green :— Capital .. .. £5,000 Premium .. 3,000		8,000	0	0		By Cash :— Black, ⅔ Premium .. .. £2,000 White, ⅓ Premium 1,000		3,000	0	0

The above transactions would be posted as follows :—

Capital, G. Green, £5,000, to the credit of his Capital Account in the Private Ledger.

Premium, £3,000, as to £2,000 (two-thirds) to the credit of Black's Current Account, and as to £1,000 (one-third) to the credit of White's Current Account.

Cash, £3,000, as to £2,000 to the debit of Black's Current Account as an ordinary drawing, and as to £1,000 to the debit of White's Current Account.

EXAMINATION QUESTION.

F and G agree to admit H as a partner as from January 1, 19.., upon the following terms : (*a*) H to bring in £5,000, of which £1,500 is to be regarded as a premium and credited equally to F and G. (*b*) Profits to be divided as follows : F and G, two-fifths each ; H, one-fifth.

The Balance Sheet of F and G at December 31st last, was as under :—

Liabilities.		£ s. d.	Assets.	£	£ s. d
Creditors		5,790 10 0	Plant, etc.	15,300	
Capital—	£		*Less* Depreciation ..	3,300	
F	8,500				12,000 0 0
G	8,500		Debtors	4,600	
		17,000 0 0	*Less* Reserve	940	
					3,660 0 0
			Stock		5,720 6 8
			Bank		1,410 3 4
		£22,790 10 0			£22,790 10 0

Draft the Balance Sheet of the new firm on January 1st. (*Incorporated Accountants.*)

Solution.

CASH BOOK.

Dr.			£	s.	d.			£	s.	d.
19.. Jan. 1	To Cash, H :—									
	Capital		3,500	0	0					
	Premium :—									
	F	£750								
	G	750								
			1,500	0	0					Cr.

F, G & H.

BALANCE SHEET, JANUARY 1, 19..

		£	s.	d.			£	s.	d.
Capital :—					Plant, etc.	£15,300			
F	£9,250				*Less* Depreciation ..	3,300			
G	9,250						12,000	0	0
H	3,500				Debtors	4,600			
		22,000	0	0	*Less* Reserve	940			
Creditors		5,790	10	0			3,660	0	0
					Stock		5,720	6	8
					Bank		6,410	3	4
	£	27,790	10	0		£	27,790	10	0

Examination candidates frequently fail to understand that, in circumstances such as those dealt with in the illustration at p. 159, *no goodwill account should be opened.* The premium has been paid in place of a goodwill account. Examination questions frequently deal with the admission of a new partner who pays in cash capital, and a further sum as the " purchase price of a share in the unrecorded goodwill." In answering such questions, it is quite inaccurate to open a goodwill account. The premium is to be divided between the old partners in the same proportion in which those partners shared profits and losses, as shown in the illustration given above. It is very important that the student should realise that in all cases where a new partner is admitted to a firm *a new firm has come into existence*, and that henceforth the new partner has equal rights with the old partners in the management of the business and to a share in the goodwill, subject, of course, to any modifications that may be imposed by the articles of partnership.

Premium Paid for Fixed Partnership Term.—Where a premium has been paid for a fixed partnership term, and dissolution occurs before the expiration of the fixed term, the partner paying the premium has the right (by S. 40 of the *Partnership Act*, 1890) to apply to the Court for repayment of the premium, or such part thereof as may be deemed just having regard to the actual duration of the partnership. As a general rule, judgment in such cases follows the judgment in *Attwood* v. *Maud*, (1868), L.R. 3 Ch. 369, and repayment is ordered to be made on a time basis, i.e. according to the proportion which the unexpired part of the partnership bears to the whole term agreed upon.

Goodwill on Partner's Death or Retirement.—Unless the partnership agreement directs that on the death or retirement of a partner the goodwill is to pass to the remaining partners, either event necessitates the valuation of the goodwill. A goodwill exists, and it is an asset in which all the partners are entitled to share, including the retiring, or the representatives of a deceased, partner.

Modern partnership agreements usually define the basis upon which goodwill is to be valued when the need arises. Sometimes (*a*) its value is fixed at a definite sum, or (*b*) its value may be based upon the average profits of a stated number of years, or (*c*) it may be valued on a basis of turnover of specified years, or (*d*) it may be valued by an independent accountant or other person on all the facts known to him. Occasionally (*e*) varying amounts are agreed as representing the goodwill value of the individual partners. In such cases, an endeavour is made to assess the goodwill loss which would be sustained by the firm by the death of each partner. For example, the death of the founder, and senior partner, of a firm might greatly reduce the value of the goodwill passing to the surviving partners. Such treatment needs delicate handling, and is infrequently met with.

If the partnership agreement lays down no basis for determining the value of the goodwill, its value must be settled by agreement between the partners, or by arbitration, or, in the last resort, by litigation, or by sale for the best price it will command (*re David and Matthews*, [1899] 1 Ch. 378).

Illustration.—A, B, and C are in partnership sharing profits respectively in the proportion three-sixths, two-sixths, and one-sixth. B dies on November 1, 19... The articles provide that, in the event of a partner's death, goodwill is to be valued at an amount equal to the average profits of the three years ended on December 31st next following the death. The Balance Sheet at that date is to form the basis on which the representatives of the deceased are to be paid out. Profits for the three years were: £8,150, £6,400, £8,850—an average profit of £7,800. The Balance Sheet of the firm at December 31, 19.., following the death, excluding goodwill, was as follows:—

A, B & C

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Freehold Property	12,876	0	0
A	£10,000				Machinery and Plant	7,224	0	0
B	7,800				Sundry Assets	11,300	0	0
C	5,722							
		23,522	0	0				
Creditors		7,878	0	0				
	£	31,400	0	0	£	31,400	0	0

In order to carry out the provisions of the partnership agreement, a goodwill account must be opened equal in amount to the average of the three years' profits, viz. £7,800, and a like amount must be

credited to the capital accounts of the partners in the same proportions as profits are shared. The new Balance Sheet, including the goodwill, will appear as follows :—

A, B & C.

BALANCE SHEET, DECEMBER 31, 19...

			s.	d		£	s.	d.
Capital :—					Goodwill Account	7,800	0	0
A : Balance..	£10,000				Freehold Property	12,876	0	0
Share of Goodwill	3,900				Machinery and Plant	7,224	0	0
		13,900	0	0	Sundry Assets	11,300	0	0
B : Balance..	7,800							
Share of Goodwill	2,600							
		10,400	0	0				
C : Balance..	5,722							
Share of Goodwill	1,300							
		7,022	0	0				
Sundry Creditors		7,878	0	0				
	£	39,200	0	0	£	39,200	0	0

The balance shown in this way to be due to B's representatives must be paid out in accordance with the articles of partnership. Usually, two, or more, years are allowed for payment of the sum due, in half-yearly instalments of agreed amount with interest at 5 % per annum on the balance outstanding.

The surviving partners, A and C, have now become sole owners of the goodwill, and can, if they so desire, eliminate the asset from the books.

Illustration.—Take the above details, and assume that, upon B's death, A and C now agree (for a consideration as between A and C) to share profits in the proportion of two-thirds and one-third respectively, and that they have decided to write off the goodwill. The entries required are given below :—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundries :— Dr.							
	A, Capital Account		5,200	0	0			
	C, Capital Account		2,600	0	0			
	To Goodwill Account					7,800	0	0
	Being transfer of the latter account to eliminate the asset from the books.							

As an alternative, and to avoid opening a goodwill account, A and C could have passed the necessary credit to B's capital account (on the old profit-sharing basis) by the following entry :—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundries :— Dr.							
	A, Capital Account		1,950	0	0			
	C, Capital Account		650	0	0			
	To B, Capital Account					2,600	0	0
	Being share of goodwill due to the representatives of B as per terms of the partnership agreement.							

A further journal entry would then have been necessary to adjust the goodwill in view of the change in A and C's profit-sharing ratio :—

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			Dr. £	s.	d.	Cr. £	s.	d.
19 .. Dec. 31	C Capital Account .. .. Dr.		650	0	0			
	To A, Capital Account					650	0	0
	Transfer of one-twelfth of Goodwill from C to A on the alteration of A's profit-sharing ratio from 9/12ths to 8/12ths, and C's from 3/12ths to 4/12ths in the terms of the new agreement.							

Goodwill Partly Paid for in Kind.—It sometimes happens that when two businesses are amalgamated, the absorbing firm accepts the transfer of certain assets from the smaller business by way of part purchase for the goodwill.

Illustration.—George and Hugh Dickson are equal partners in a cigarette manufacturing business. Their Balance Sheet at December 31, 19.., was as follows :—

G. & H. Dickson.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Capital :—				Freehold Factory	24,785	0	0
G. Dickson £15,000				Machinery and Plant	4,745	0	0
H. Dickson 14,500				Stock	9,404	0	0
	29,500	0	0	Sundry Debtors	2,052	0	0
Sundry Creditors	11,486	0	0	Cash	1,895	0	0
Bills Payable	1,895	0	0				
£	42,881	0	0	£	42,881	0	0

On January 1, 19.., the partners agree to admit A. Chatenay, also a cigarette manufacturer, as a partner, on the following terms : Chatenay is to pay £2,000 to G. and H. Dickson as premium for admission, and also to contribute £6,000 as capital. It is agreed that in part payment of the latter sum certain of Chatenay's business assets shall be taken over at the following valuations : Machinery and Plant, £1,956 ; Stock, £2,194 ; Sundry Debtors, £900, less 5 % reserve for bad debts. The premium to be paid by A. Chatenay is to be left in the business as additional capital. The book-keeping record is as follows :—

1 CASH BOOK. 2

Dr.			£	s.	d.			Cr. £	s.	d.
19... Jan. 1	To Balance brought forward	√	1,895	0	0					
" 1	" Cash, A. Chatenay, Premium :— G. Dickson £1,000	2								
	H. Dickson 1,000	4	2,000	0	0					
" 1	" Cash, A. Chatenay, Balance to make up Capital Account to £6,000	6	995	0	0					
		£	4,890	0	0					

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			Dr. £	s.	d.	Cr. £	s	d.
19... Jan. 1	Sundries :— Dr.							
	Machinery and Plant	11	1,056	0	0			
	Stock	13	2,194	0	0			
	Debtors	15	900	0	0			
	To A. Chatenay, Capital Account	6				5,050	0	0
	For Sundry Assets taken over this day in part discharge of Capital to be paid in.							
„ 1	A. Chatenay, Capital Account Dr.	5	45	0	0			
	To Bad Debts Reserve	8				45	0	0
	For Reserve on Book Debts taken over as agreed.							

LEDGER.

1 G. Dickson. Capital Account. 2

Dr.			£	s.	d.	19...	Cr.		£	s.	d.
						Jan. 1	By Balance	√	15,000	0	0
						„ 1	„ Cash, ½ Premium	C.B. 1	1,000	0	0
								£	16,000	0	0

3 H. Dickson. Capital Account. 4

Dr.			£	s.	d	19...	Cr.		£	s.	d.
						Jan 1	By Balance	√	14,500	0	0
						„ 1	„ Cash, ½ Premium		1,000	0	0
								£	15,500	0	0

5 A. Chatenay. Capital Account. 6

Dr. 19...		J.	£	s.	d	19...	Cr.	J.	£	s.	d.
Jan. 1	To Bad Debts Reserve	1	45	0	0	Jan. 1	By Sundry Assets	1	5,050	0	0
„ 1	„ Balance carried down	√	6,000	0	0	„ 1	„ Cash	C.B. 1	995	0	0
			£6,045	0	0				£6,045	0	0
						19... Jan 1	By Balance brought down	√	6,000	0	0

7 Bad Debts Reserve. 8

Dr.			£	s.	d.	19...	Cr.	J.	£	s.	d.
						Jan. 1	By Transfer (Chatenay's Capital Account)	1	45	0	0

9 Freehold Factory. 10

Dr. 19...			£	s.	d.		Cr.		£	s.	d.
Jan. 1	To Balance	√	24,785	0	0						

LEDGER—*continued.*

11 MACHINERY AND PLANT. 12

Dr.			£	s.	d.				Cr. £	s.	d.
19... Jan. 1	To Balance ..	√	4,745	0	0						
" 1	" Sundries (A. Chatenay) ..	J.1	1,956	0	0						
			£6,701	0	0						

13 STOCK. 14

Dr.			£	s.	d.				Cr. £	s.	d.
19.. Jan. 1	To Balance ..	√	9,404	0	0						
" 1	" Sundries (A. Chatenay) ..	J.1	2,194	0	0						
		£	11,598	0	0						

15 SUNDRY DEBTORS. 16

Dr.			£	s.	d.				Cr. £	s.	d.
19... Jan. 1	To Balance ..	√	2,052	0	0						
" 1	" Sundries (A. Chatenay) ..	J.1	900	0	0						
			£2,952	0	0						

17 SUNDRY CREDITORS. 18

Dr.			£	s.	d.				Cr. £	s.	d.
						19... Jan. 1	By Balance	√	11,486	0	0

19 BILLS PAYABLE. 20

Dr.			£	s.	d.				Cr. £	s.	d.
						19... Jan. 1	By Balance	√	1,895	0	0

The Balance Sheet of the firm after the admission of A. Chatenay would appear as follows :—

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.			£	s.	d.
Capital :—					Freehold Factory		24,785	0	0
G. Dickson	£16,000				Machinery and Plant		6,701	0	0
H. Dickson	15,500				Stock		11,598	0	0
A. Chatenay	6,000				Sundry Debtors	£2,952			
		37,500	0	0	*Less* Reserve .. .	45			
Sundry Creditors		11,486	0	0			2,907	0	0
Bills Payable		1,895	0	0	Cash		4,890	0	0
	£	50,881	0	0		£	50,881	0	0

Guarantees on Amalgamation.—It sometimes happens when businesses are amalgamated, or assets are taken over in lieu of cash, as illustrated in the above example, that an agreement is entered into by the incoming partner guaranteeing the book value of such assets The original parties may also, on their part, guarantee the value of some of their assets, e.g. book debts. They may also undertake that their liabilities shall not exceed the amount at which they stand in the Amalgamation Balance Sheet. Should the assets not realise the guaranteed book values or the liabilities exceed the guaranteed limit, the differences must be treated as personal debts due from the guarantors. They may be made good either by cash payment or by a debit to the Capital Account or Accounts concerned.

Illustration.—Assume the details given in the previous illustration, and that the assets taken over from A. Chatenay were guaranteed by him to be of the values stated in the Journal entry dated June 1, 19... A subsequent independent valuation of the Machinery and Plant was made, and its value was fixed at £1,895. The necessary adjustment is as follows :—

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		L.F.	DR. £	s.	d.	CR. £	s.	d.
19... Feb. 14	A Chatenay, Capital Account .. .. Dr.		61	0	0			
	To Machinery and Plant Account					61	0	0
	Being shortage in the value of this asset guaranteed at £1,956 and now valued at £1,895.							

Summary of Treatment of Goodwill.—In view of the confusion shown by some examination candidates in the treatment of goodwill, it may be useful to summarise the various ways in which goodwill may arise in partnership accounts and its proper treatment.

(A) *Data.*—New partner is to pay the old partners a fixed amount, £2,000, for a share of unrecorded goodwill, and is to introduce an agreed amount, £5,000, as capital.

Entries.—No entries are required in the books of the new firm for the £2,000 goodwill. The amount will be paid *direct* to the old partners in the proportion in which they shared profits. This £2,000 is not paid into the firm's account, but privately to the old partners, unless, of course, they agree to pay it in as additional capital as in (*c*). The £5,000 capital will be debited on receipt to Cash and posted to the credit of the new partner's Capital Account. *No goodwill account is to be opened.*

(B) *Data.*—An agreed amount, £2,000, is to be treated as the value of the firm's goodwill. The new partner is to pay in £5,000 as capital.

Entries.—A Goodwill Account must be opened and debited with £2,000. The Capital Accounts of the old partners

must be *credited* with £2,000 in the proportions in which they shared profits. The £5,000 paid in by the new partner will be treated as in A above.

(C) *Data.*—The new partner is to pay £2,000 for a share of goodwill and the amount is to be left in the business. He is also to pay in £5,000 as capital.

Entries.—The £2,000 for goodwill must be debited to cash on receipt, and posted to the credit of the Capital Accounts of the old partners in the proportion in which they shared profits. The £5,000 paid in as capital will be treated as in A and B above. *No goodwill account is to be opened.*

(D) *Data.*—On the death (or retirement) of a partner, goodwill is to be valued in accordance with the terms of the partnership deed; for example, it is to be taken as of the value of the average profits for the three years ended on December 31st next following the death (or retirement) of the partner.

Entries.—Assuming that the average of the three years' profits is, e.g., £5,000, open a Goodwill Account and debit it with £5,000, and credit the like sum to the Capital Accounts of the partners, including that of the deceased (or retiring) partner, in the proportion in which profits are shared. The books will then show the amount to be accounted for to the representatives of the deceased, or to the retiring, partner.

EXAMINATION QUESTION.

Blank found himself in the position disclosed in the following statement on December 31st :—

LIABILITIES.	£	ASSETS.	£
Sundry Creditors	3,630	Sundry Debtors	2,082
Preferential Creditors ..	185	Bills Receivable	120
Bank Overdraft	250	Stock	942
Abel Chatenay (loan) ..	800	Machinery	1,000
		Cash in hand	15
		Deficiency	706
	£4,865		£4,865

The following arrangements were entered into with the parties concerned. The preferential creditors and the bankers were to be paid in full. The trade creditors were to accept 15s. in the £ in full settlement. Abel Chatenay was to join Blank as a partner, introducing £2,000 into the business, and the loan of £800 was to be transferred to his capital account. The Sundry Debtors were valued at £1,740. The Stock was written down to £700, and the Machinery to £800. Any profit or loss arising out of the above settlement was to be carried to Blank's Capital Account.

Prepare a statement showing the position of the new firm upon the completion of the above settlement. (*London Chamber Commerce.*)

Solution.

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		Dr. £	s.	d.	Cr. £	s.	d.
19 .. Dec. 31	Sundry Creditors .. .. Dr.	907	10	0			
	To Realisation Account				907	10	0
	Being 5s. in the £ written off these debts.						
,, 31	Realisation Account .. .. Dr.	784	0	0			
	To Sundry Assets :—						
	Sundry Debtors				342	0	0
	Stock				242	0	0
	Machinery				200	0	0
	Being loss on revaluation of these assets.						
,, 31	Realisation Account .. .. Dr.	123	10	0			
	To Blank, Capital Account				123	10	0
	Being profit on rearrangement of business.						

BLANK. CAPITAL ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
19... Dec. 31	To Balance	706	0	0	19... Dec. 3	By Realisation Account	123	10	0
					,, 31	,, Balance carried down	582	10	0
		£706	0	0			£706	0	0
19... Dec. 31	To Balance brought down	582	10	0					

Blank and Chatenay.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Capital :—				Sundry Debtors	1,740	0	0
Chatenay	2,800	0	0	Bills Receivable	120	0	0
Bank Overdraft	250	0	0	Stock	700	0	0
Sundry Creditors	2,722	10	0	Machinery	800	0	0
Preferential Creditors	185	0	0	Cash in hand	15	0	0
				Cash at Bank	2,000	0	0
				Blank (debit balance of Capital Account)	582	10	0
£	5,957	10	0	£	5,957	10	0

Share of Late Partner Continued as Loan.—Articles of partnership sometimes provide that when the amount due to a deceased partner has been ascertained, it shall be treated as a loan, carrying interest at an agreed rate, and be payable in a stated number of instalments at fixed intervals. In such cases, the capital account of the deceased

partner is credited with interest at the agreed rate, and debited with the instalments as and when paid.

Illustration.—B. Black, W. White, and C. Brown were in partnership. Black died, and the amount due to him as on the date of death was agreed with his representatives at £5,080. By the partnership articles this sum was repayable in ten equal yearly instalments, and interest at 5 % per annum on the current balance was to be paid in cash at the close of each year. Assuming the death of Black to have taken place on December 31, 19.., the Capital Account on the following December 31st would appear as follows :—

B BLACK (THE LATE). LOAN ACCOUNT.

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Cash (1st Instalment)	C.B.	508	0	0	19 .. Dec. 31	By Transfer from Capital Account	J.	5,080	0	0
" 31	" Cash (Interest)		254	0	0	19... Dec. 31	" Interest at 5 %	J.	254	0	0
" 31	" Balance carried down	✓	4,572	0	0						
		£	5,334	0	0			£	5,334	0	0
						19... Dec. 31	By Balance brought down		4,572	0	0

Survivorship Assurance Policies.—A modern practice, growing in popularity, is to take out a partnership joint policy of assurance for an agreed sum, so that upon the death of a partner the proceeds of the policy become available to discharge the amount due to the representatives of the partner. In this way, undue strain upon the firm's financial resources is avoided. The annual premiums are charged against the firm's Profit and Loss Account. When, owing to death or maturity of the policy, the sum assured is received, it represents accumulated undivided profits, divisible in the proportions in which the partners share profits and losses, and is credited to the Capital Accounts.

Illustration.—P. Helyet, C. Testout, and A. Pillar are in partnership, sharing profits respectively in the proportion one-half, one-quarter, one-quarter. Helyet has contributed £15,000 Capital ; Testout, £7,500 ; and Pillar, £6,000. Interest at 5 % is allowed on capital, but no interest is charged on drawings. Testout and Pillar are each credited with a partnership salary of £500 on December 31st of each year. On the death of a partner, goodwill is to be valued at one year's purchase of the average profit for the three years immediately preceding the death. A policy of assurance for £12,000 is to be taken out on the joint lives of the three partners. Testout died on December 31, 19... His drawings for the year ended on the same date were £2,286. The results of the firm's trading for the three years ended on the date of death were £7,878 (profit), £5,278 (profit), but for the year of Testout's death a loss of £480. After the necessary adjustments, C. Testout's Capital and Currents Accounts would appear as follows :—

C. TESTOUT. CAPITAL ACCOUNT.

Dr.			£	s.	d.		Cr.		£	s.	d
19... Dec. 31	To Balance carried down		11,556	6	8	19... Dec. 31	By Balance		7,500	0	0
						" 31	" Share of Goodwill (¼ of £4,225 6s 8d.)		1,056	6	8
						" 31	" Share of Assurance Policy (¼ of £12,000)		3,000	0	0
		£	11,556	6	8			£	11,556	6	8
						19... Dec. 31	By Balance brought down		11,556	6	8

C. TESTOUT. CURRENT ACCOUNT.

Dr.			£	s.	d		Cr.		£	s.	d.
19... Dec. 31	To Drawings		2,286	0	0	19... Dec 31	By Interest on Capital		375	0	0
" 31	" Share of Loss ..		120	0	0	" 31	" Salary		500	0	0
						" 31	" Balance carried down		1,531	0	0
			£2,406	0	0				£2,406	0	0
19... Dec. 31	To Balance brought down		1,531	0	0						

GOODWILL VALUATION.

		£	s.	d.		£	s.	d.
1st Year Profit		7,878	0	0				
2nd Year Profit		5,278	0	0				
		13,156	0	0				
Less 3rd Year Loss		480	0	0				
	£	12,676	0	0				
One year's purchase		4,225	6	8				

Partners sometimes prefer not to charge the whole of the premiums to Profit and Loss Account. A "Life Policy Account" is then opened, and that portion of the annual premium which is represented by the increased surrender value of the policy is credited to "Life Policy Premium Account," and debited to "Life Policy Account." By this method, the latter account shows at any time the present surrender value of the policy. When the policy matures, the amount received from the assurance company is credited to "Life Policy Account" and the balance in excess of the surrender value is divided between the partners.

Illustration.—Dickson and Jones are equal partners. They have taken out a joint policy for £5,000 at an annual premium of £135. After the policy has been running for some years, Dickson dies. The amount due under the policy was paid on December 31, 19... The following Ledger accounts concern the policy :—

1 LIFE POLICY PREMIUM ACCOUNT. 2

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Cash, Annual Premium.. ..	C.B.	135	0	0	19... Dec. 31	By Transfer to Life Policy Account (increase in surrender value) ..	3	45	0	0
						" 31	" Profit and Loss Account	P.L.	90	0	0
			£135	0	0				£135	0	0

3 LIFE POLICY ACCOUNT. 4

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance (surrender value at date)	√	2,563	0	0	19... Dec. 31	By Cash, Proceeds of Policy	C.B.	5,000	0	0
" 31	" Transfer from Life Policy Premium Account	2	45	0	0						
" 31	" Dickson, Capital Account (share of balance) .		1,196	0	0						
" 31	" Jones, Capital Account (share of balance) ..		1,196	0	0						
		£	5,000	0	0			£	5,000	0	0

New Partner and Revaluation of Assets.—The admission of a new partner may afford a favourable opportunity to revalue some of the assets of the old firm, indeed a new partner may make this a condition of his entry as partner. Some of the assets may have appreciated in value above their book values, others, on the other hand, may have depreciated. Freehold property, for example, may be retained in the books at its original cost, notwithstanding that it has greatly increased in value. Plant and Machinery may appear at a figure above its actual market value. Appreciations and depreciations disclosed upon revaluation, or agreed upon by mutual consent, must be treated as partnership profits and losses and be divided between the partners in the proportions in which profits and losses are shared.

Illustration.—G. Dickson and A. Chatenay are equal partners. On January 1, 19.., they agree to admit G. Wand as partner. Wand is to pay £2,000 as a premium—the money to be left in the business—and contribute £5,000 as capital. The Balance Sheet of the old firm as at December 31, 19.., was as follows :—

Dickson & Chatenay.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital :—					Freehold Property	7,962	0	0
G. Dickson	£10,000				Machinery and Plant	6,841	0	0
A. Chatenay	8,000				Sundry Debtors	10,210	0	0
		18,000	0	0	Stock	3,528	0	0
Sundry Creditors		7,862	0	0	Bank (Current Account)	321	0	0
Bank Loan		2,000	0	0				
Reserve Account		1,000	0	0				
	£	28,862	0	0	£	28,862	0	0

It was agreed after negotiation between the parties that the following adjustments in the book values were to be made :—

		£
(*a*)	Freehold Property to be valued at	12,000
(*b*)	Machinery and Plant to be reduced to	5,000
(*c*)	Bad Debts to the amount of £749 to be written off ..	749
(*d*)	Stock to be valued at	3,000
(*e*)	Reserve Account to be transferred to Revaluation Account.	

The Revaluation Account would appear as follows :—

REVALUATION ACCOUNT.

Dr. Cr.

	£	s.	d.		£	s.	d.
To Machinery and Plant (Depreciation)	1,841	0	0	By Freehold Property (Appreciation)	4,038	0	0
,, Bad Debts (written off)	749	0	0	,, Reserve Account (transfer) ..	1,000	0	0
,, Stock (amount written off) ..	528	0	0				
,, Balance carried down	1,920	0	0				
£	5,038	0	0	£	5,038	0	0
To G. Dickson, Capital Account ..	960	0	0	By Balance brought down	1,920	0	0
,, A. Chatenay, Capital Account..	960	0	0				
£	1,920	0	0	£	1,920	0	0

The Balance Sheet of the new firm, as at January 1, 19.., would appear as shown on p. 172.

EXAMINATION QUESTION.

George McArthur and Arthur Hadley were equal partners. McArthur died on December 30, 19... Accounts were prepared at the close of the financial year (December 31st), when it was found, after ascertaining and crediting the profit for the previous year in the ordinary way, that the partners' accounts stood as follows : McArthur, Capital Account, £8,000 ; Current Account (Credit Balance), £962. Hadley, Capital Account, £7,000 ; Current Account (Credit Balance), £852.

It was agreed with McArthur's executors that the value of the Goodwill, which had not hitherto appeared in the books, should be fixed at £3,000, and that the assets and liabilities should be reviewed. Valuations were made

Dickson, Chatenay & Wand.

BALANCE SHEET, JANUARY 1, 19..

		£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Capital—								Freehold Property	7,962	0	0			
G. Dickson	£10,000							*Add* Appreciation	4,038	0	0			
½ Share Premium	1,000											12,000	0	0
½ Share Revaluation	960							Machinery and Plant	6,841	0	0			
		11,960	0	0				*Less* Depreciation..	1,841	0	0			
A. Chatenay ..	£8,000											5,000	0	0
½ Share Premium	1,000							Sundry Debtors	10,210	0	0			
½ Share Revaluation	960							*Less* Bad Debts	749	0	0			
		9,960	0	0								9,461	0	0
G. Wand		5,000	0	0				Stock	3,528	0	0			
					26,920	0	0	*Less* Amount written off ..	528	0	0			
Sundry Creditors					7,862	0	0					3,000	0	0
Bank Loan					2,000	0	0	Bank (Current Account) ..	321	0	0			
								Add Cash paid in by G. Wand	7,000	0	0			
												7,321	0	0
				£	36,782	0	0				£	36,782	0	0

with the following results: The book value of the Plant and Machinery was reduced by £500; the Reserve for Bad Debts was found to be excessive by £200; the Stock was undervalued by £350; the Sundry Creditors were overstated by £670; and the Patents (book value, £300) were held to be of no value.

Submit the partners' accounts as they would appear in the Revaluation Balance Sheet. (*Royal Society Arts.*)

Solution.

REVALUATION ACCOUNT.

Dr.			£	s.	d.		Cr.		£	s.	d.
19.. Dec. 31	To Plant and Machinery (Depreciation) ..		500	0	0	19... Dec. 31	By Goodwill		3,000	0	0
" 31	" Patents (written off)		300	0	0	" 31	" Reserve for Bad Debts (excess) ..		200	0	0
" 31	" Balance carried down		3,420	0	0	" 31	" Stock (appreciation)		350	0	0
						" 31	" Sundry Creditors (overstatement) ..		670	0	0
		£	4,220	0	0			£	4,220	0	0
19.. Dec. 31	To McArthur, Capital Account		1,710	0	0	19... Dec. 31	By Balance brought down		3,420	0	0
" 31	" Hadley, Capital Account		1,710	0	0						
		£	3,420	0	0			£	3,420	0	0

McArthur & Hadley.

REVALUATION BALANCE SHEET, DECEMBER 31, 19...

(Partners' Accounts Only.)

Dr.		£	s.	d.	Cr.	£	s.	d.
Capital :—								
G. McArthur	£8,000							
Share of revaluation profit	1,710							
		9,710	0	0	Note.—It would be equally correct to carry one half-share of the goodwill, as a separate item, to the credit of each partner.			
A. Hadley	7,000							
Share of revaluation profit	1,710							
		8,710	0	0				
Current Accounts :—								
G. McArthur	£962							
A. Hadley	852							
		1,814	0	0				

Amalgamation of Two Businesses.—Not infrequently, two or more sole traders engaged in the same trade, or two or more sole professional practitioners, agree to amalgamate their assets and liabilities to form a partnership. In such circumstances, the Balance Sheet of each business or profession usually requires careful revision, and agreement must first be reached as to any adjustments in the value of the assets or the extent of the liabilities that may be necessary. In some cases the goodwill of the amalgamating concerns may be conspicuously unequal in value, and equitable recognition of the inequality

must be effected in the books of the new partnership. The book-keeping principles involved are precisely the same as in the case of amalgamating limited companies (see pp. 470 *et seq.*). The Balance Sheet of each of the amalgamating parties must be re-drafted to accord with the adjustments agreed upon, and the re-drafted Balance Sheets combined will then form the initial Balance Sheet of the new partnership.

EXAMINATION QUESTION.

Grey and Green amalgamated their businesses on January 1st, their Balance Sheets being as follows :—

G. GREY.

Liabilities.	£	Assets.	£
Creditors	500	Plant	5,000
Bank Overdraft	250	Debtors	1,000
Capital	7,250	Stock	2,000
	£8,000		£8,000

G. GREEN.

Liabilities.	£	Assets.	£
Creditors	400	Plant	500
Capital	1,935	Debtors	700
		Stock	300
		Cash	835
	£2,335		£2,335

(*a*) Prepare opening Balance Sheet for the partnership having regard to the following adjustments: Grey to be credited with goodwill, £3,000; Green to be credited with goodwill, £500; the value of Grey's plant to be reduced by 10 % and his stock by 5 %; the overdraft is paid off; a Reserve Account of 5 % on all debtors to be raised.

(*b*) Show their Capital Accounts at June 30th, the net profit for the half-year having been £4,000. Allow 5 % interest on capital, and divide the profit as to two-thirds to Grey and one-third to Green. (*Central Association Accountants.*)

Solution.

G. Grey's Books

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Date	Particulars		Dr. £	s.	d.	Cr. £	s.	d.
19.. Jan. 1	Capital Account .. Dr.		650	0	0			
	To Plant Account (Depreciation)					500	0	0
	" Stock (Depreciation)					100	0	0
	" Sundry Debtors (Reserve)					50	0	0
	Being decrease in the valuation of these assets.							
" 1	Goodwill Account .. Dr.		3,000	0	0			
	To Capital Account					3,000	0	0
	Being agreed value of goodwill.							

G. Grey.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.		£	s.	d.
Capital Account :—					Goodwill	3,000	0	0
Balance	£7,250				Plant	4,500	0	0
Goodwill	3,000				Debtors	950	0	0
Overdraft paid off	250				Stock	1,900	0	0
	10,500							
Less Loss on Revaluations	650							
		9,850	0	0				
Creditors		500	0	0				
	£	10,350	0	0	£	10,350	0	0

NOTE.—It is assumed that Grey paid off the overdraft out of private funds, as there is no cash balance.

G. GREEN'S BOOKS.

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Jan. 1	Goodwill Account .. .. Dr. To Capital Account Being the agreed value of this asset.		500	0	0	500	0	0
" 1	Capital Account .. .. Dr. To Sundry Debtors Being reserve of 5 % on these debts.		35	0	0	35	0	0

G. Green.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.		£	s.	d.
Capital Account :—					Goodwill	500	0	0
Balance	£1,935				Plant	500	0	0
Goodwill	500				Debtors	665	0	0
	2,435				Stock	300	0	0
Less Reserve for Bad Debts	35				Cash	835	0	0
		2,400	0	0				
Creditors		400	0	0				
		£2,800	0	0		£2,800	0	0

Grey & Green.

BALANCE SHEET, JANUARY 1, 19...

(UPON AMALGAMATION.)

		£	s.	d.		£	s.	d.
Capital :—					Goodwill	3,500	0	0
G. Grey	£9,850				Plant	5,000	0	0
G. Green	2,400				Stock	2,200	0	0
		12,250	0	0	Debtors	1,615	0	0
Creditors		900	0	0	Cash	835	0	0
	£	13,150	0	0	£	13,150	0	0

Grey & Green.

BALANCE SHEET, JUNE 30, 19...

(CAPITAL AND CURRENT ACCOUNTS ONLY.)

				£	s.	d.		£	s.	d.
Capital Accounts :—										
G. Grey	£9,850	0	0							
G. Green	2,400	0	0							
				12,250	0	0				
Current Accounts :—										
G. Grey—										
Interest on Capital (6 months) ..	246	5	0							
⅔ds Profit	2,462	10	0							
				2,708	15	0				
G. Green—										
Interest on Capital (6 months) ..	60	0	0							
⅓rd Profit . ..	1,231	5	0							
				1,291	5	0				

Annuities and Partnership Accounts.—Some partnership deeds provide that on the death of a partner an annuity of agreed amount shall be paid for a fixed term to the deceased partner's representatives in lieu of a share of the goodwill arrived at in the manner described above. The usual practice in circumstances of this sort is to charge the annuity against the current Profit and Loss Account as an annual expense. But there is no objection, as an alternative method, to debiting the annual payments to goodwill, provided that that account is kept within reasonable bounds.

Dissolution.—Dissolution of partnership may result from several causes, viz. the death, bankruptcy, or lunacy of a partner; the expiration of the partnership term; the termination of the undertaking for which the partnership was formed; inability of the partners to work together in harmony, etc. It has already been stated that upon dissolution the partnership assets are applied as follows: First, in payment of debts due to outside creditors; secondly, in repayment of loans from partners; thirdly, in repayment of partners' capital; and lastly, in the distribution of the surplus, if any, amongst the partners in the proportions in which they share profits. If the assets realise less than the amount necessary to discharge the first three sets of liabilities, it is clear that there is a deficiency, which must be apportioned so that the rights of the partners as between themselves may be adjusted equitably.

Students sometimes make the mistake of assuming that partners are entitled to share the *assets* of the firm in the same proportions in which they share *profits*, and proceed to solve a dissolution problem on that basis. That, of course, is a serious error. On dissolution, the share of each partner in the assets is fixed by the amount standing to his credit on Capital and Current Account, any profit or loss on dissolution having first been apportioned in the proportion in which the partners share trading profits

Illustration.

BALANCE SHEET.

(ON COMPLETION OF WINDING UP.)

		£	s.	d.		£	s.	d.
Capital :—					Cash at Bank (after paying all liabilities)	11,146	0	0
A. B.	£5,000							
C. D.	4,000							
		9,000	0	0				
Current Accounts :—								
A. B.	1,926							
C. D.	220							
		2,146	0	0				
	£	11,146	0	0	£	11,146	0	0

A. B. and C. D. are equal partners, but they are not entitled to share the assets of the firm, i.e. Cash £11,146, equally. A. B. is entitled to be paid his capital, £5,000, plus his Current Account, £1,926, i.e. £6,926; and C. D. is entitled to £4,220.

Section 44 (*a*) of the *Partnership Act*, 1890, provides that in settling accounts between partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed: "Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits." By this clause, therefore, any losses there may be must first be charged against the partners' undrawn profits (i.e. Current Accounts), next against their Capital Accounts, and finally, should any deficiency then remain, it must be made good by actual contribution in cash.

The book-keeping entries recording a dissolution follow closely those necessary in company liquidation. A Realisation Account is opened in which must be collected the profits or losses arising from the disposal of the assets, or the settlement of the liabilities. The expenses arising from the dissolution are debited to the same account, which then shows the net profit resulting from the winding up of the business. The resulting profit, or loss, is transferred to the partners' Current Accounts, in the same proportion in which trading profits and losses are shared. The balance of cash available will then exactly suffice to discharge the credit balances of the partners' Capital and Current Accounts. Should the Capital Account of any partner show a debit balance, he must pay in the amount necessary to make good the deficiency, since, in effect, he has overdrawn his Capital Account. It is important to remember that, in the absence of special agreement, no partner can claim interest on capital or partnership salary beyond the date of dissolution, however long the winding-up procedure may take. In the author's experience, some examination candidates treat the balance of cash available upon dissolution as a profit, and proceed to divide it as such. It is the *profit or the loss* on

realisation which must be apportioned, and not the amount finally shown as available. If the dissolution accounts are correct, the amount shown as due on the partners' Capital Accounts will be exactly discharged by the balance of cash available as shown by the cash book.

The following illustrations deal with some of the more common circumstances met with in partnership dissolutions.

Cessation of Business and Sale of Assets.

Illustration.—George and Hugh Dickson, trading as Dickson Brothers, are equal partners. They agree to sell their business to Chatenays, Ltd., as on December 31, 19... The purchase price is agreed at £65,000, payable in cash. The liabilities are to be paid by the purchasers, and the assets are to be taken over by the company at their book values. This illustration presents a dissolution problem in its simplest form. After final adjustments, the Balance Sheet of the firm was as follows :—

Dickson Brothers.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Capital :—				Freehold Warehouse	28,562	0	0
G. Dickson £30,000				Machinery and Plant	14,485	0	0
H. Dickson 25,000				Motor Lorries..	2,876	0	0
	55,000	0	0	Stock	9,440	0	0
Loan and Interest, G. Dickson ..	5,250	0	0	Sundry Debtors	13,212	0	0
Sundry Creditors	10,286	0	0	Cash at Bank	1,961	0	0
£	70,536	0	0	£	70,536	0	0

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Realisation Account .. .. Dr.	21	70,536	0	0			
	To Sundry Assets :—							
	Freehold Property	2				28,562	0	0
	Machinery and Plant	4				14,485	0	0
	Motor Lorries	6				2,876	0	0
	Stock	8				9,440	0	0
	Sundry Debtors	10				13,212	0	0
	Cash at Bank	12				1,961	0	0
	Being assets sold to Chatenays, Ltd., at the above prices.							
„ 31	Sundries :— Dr.							
	Sundry Creditors	13	10,286	0	0			
	Loan (G. Dickson)	15	5,250	0	0			
	To Realisation Account	22				15,536	0	0
	Being liabilities of Dickson Brothers now paid off.							
„ 31	Chatenays, Ltd. .. .. Dr.	24	65,000	0	0			
	To Realisation Account	22				65,000	0	0
	Being agreed purchase price of the business.							
„ 31	Realisation Account .. .. Dr.	21	10,000	0	0			
	To G. Dickson (Capital Account)	18				5,000	0	0
	„ H. Dickson (Capital Account)	20				5,000	0	0
	Being division of the profit on the sale of the business.							

LEDGER.

1 FREEHOLD PROPERTY. 2

DR.			£	s.	d.	CR.		J.	£	s.	d.
19... Dec 31	To Balance ..	√	28,562	0	0	19... Dec. 31	By Realisation Account	14	28,562	0	0

3 MACHINERY AND PLANT. 4

DR.			£	s.	d.	CR.		J.	£	s.	d.
19... Dec. 31	To Balance ..	√	14,485	0	0	19... Dec. 31	By Realisation Account .. .	14	14,485	0	0

5 MOTOR LORRIES. 6

DR.			£	s.	d.	CR.		J.	£	s.	d.
19... Dec. 31	To Balance ..	√	2,876	0	0	19... Dec. 31	By Realisation Account	14	2,876	0	0

7 STOCK. 8

DR.			£	s.	d.	CR.		J.	£	s.	d.
19... Dec. 31	To Balance ..	√	9,440	0	0	19... Dec. 31	By Realisation Account	14	9,440	0	0

9 SUNDRY DEBTORS. 10

DR.			£	s.	d.	CR.		J.	£	s.	d.
19... Dec. 31	To Balance ..	√	13,212	0	0	19... Dec. 31	By Realisation Account	14	13,212	0	0

11 CASH BOOK. 12

DR.			£	s.	d.	CR.		J.	£	s.	d.
19... Dec. 31	To Balance ..	√	1,961	0	0	19... Dec. 31	By Realisation Account	14	1,961	0	0
,, 31	,, Cash, Chatenays, Ltd., Purchase Price of Business ..	24	65,000	0	0	,, 31	,, Cash, G. Dickson	18	35,000	0	0
						,, 31	,, Cash, H. Dickson	20	30,000	0	0
		£	66,961	0	0			£	66,961	0	0

13 SUNDRY CREDITORS. 14

DR.		J.	£	s.	d.	CR.			£	s.	d.
19... Dec. 31	To Realisation Account	14	10,286	0	0	19... Dec. 31	By Balance	√	10,286	0	0

LEDGER—*continued.*

G. Dickson. Loan Account.

15 Dr. — Cr. 16

19... Dec. 31	To Realisation Account	J. 14	£ 5,250	s. 0	d. 0	19... Dec. 31	By Balance	√	£ 5,250	s. 0	d. 0

G. Dickson. Capital Account.

17 Dr. — Cr. 18

19... Dec 31	To Cash	C.B. 12	£ 35,000	s. 0	d. 0	19... Dec. 31	By Balance	√	£ 30,000	s. 0	d. 0
						,, 31	,, Share of Profit on Sale of Business	14	5,000	0	0
		£	35,000	0	0			£	35,000	0	0

H. Dickson. Capital Account.

19 Dr. — Cr. 20

19... Dec. 31	To Cash	C.B. 12	£ 30,000	s. 0	d. 0	19... Dec 31	By Balance	√	£ 25,000	s. 0	d. 0
						,, 31	,, Share of Profit on Sale of Business	J. 14	5,000	0	0
		£	30,000	0	0			£	30,000	0	0

Realisation Account.

21 Dr. — Cr. 22

19... Dec. 31	To Sundry Assets sold to Chatenays, Ltd. ..	J. 14	£ 70,536	s. 0	d. 0	19... Dec. 31	By Sundry Liabilities now paid off	J. 14	£ 15,536	s. 0	d. 0
,, 31	,, Balance carried down, being profit on the sale	√	10,000	0	0	,, 31	,, Chatenays, Ltd., purchase price of business	14	65,000	0	0
		£	80,536	0	0			£	80,536	0	0
19... Dec. 31	To G. Dickson ..	J. 14	5,000	0	0	19... Dec. 31	By Balance brought down	√	10,000	0	0
,, 31	,, H. Dickson ..	14	5,000	0	0						
		£	10,000	0	0			£	10,000	0	0

Chatenays, Ltd.

23 Dr. — Cr. 24

19... Dec. 31	To Realisation Account, Purchase Price of Business	J. 14	£ 65,000	s. 0	d. 0	19... Dec. 31	By Cash	C.B. 11	£ 65,000	s 0	d. 0
		£	65,000	0	0			£	65,000	0	0

Profit on Dissolution.—Where the dissolution results in a profit, the Realisation Account takes the form of a Profit and Loss Account, although, of course, in place of the usual revenue charges, it deals with the discharge of liabilities and the realisation of assets. The total assets and liabilities may be treated as in the illustration above, or the sale proceeds of the assets may be credited to the relative accounts, and the balance of profit or loss be transferred to the Realisation Account. For examination purposes it is preferable to transfer all the assets, by means of a journal entry, to the debit of the Realisation Account, and to credit the sale proceeds to the same account, thus arriving at the final balance available for distribution between the partners.

Procedure for Dissolution Problems.

(1) Open ledger accounts, (*a*) for each asset; (*b*) sundry creditors; (*c*) any other liabilities; (*d*) partners' Capital and Loan Accounts, where not already in existence. (2) Close all the asset accounts, except cash, by transfer to the Realisation Account. (3) Debit cash with the proceeds of the sale of the assets, and credit Realisation Account. (4) Credit cash with liabilities and loans, when paid, and debit the relative liability accounts. (5) Credit cash with the expenses of dissolution, and debit Realisation Account. (6) Debit partners' Capital Accounts with any assets taken over by them at the price agreed, and credit Realisation Account. (7) Credit, or debit the partners' Capital Accounts with their proportion of the profit or loss upon realisation as the case may be. (8) If any partner's Capital Account is in debit, assume that the deficiency is made good, and debit cash and credit the relative Capital Account. (9) After the procedure indicated above, the cash balance available should exactly equal the aggregate balances shown by the Capital Accounts of the partners.

In practice, Debtors and Creditors are not taken over in order to save Transfer Duties, etc.

Illustration.—G. McArthur and C. Testout agree to dissolve partnership and retire from business as on December 31, 19... Profits and losses are shared as to two-thirds and one-third respectively. The Balance Sheet of the firm, as on the date of retirement, was as follows :—

McArthur & Testout.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital :—					Freehold Factory	18,485	0	0
McArthur	£30,000				Machinery and Plant	9,875	0	0
Testout	10,000				Sundry Debtors	7,546	0	0
		40,000	0	0	Stock	9,462	0	0
Loan Account		3,000	0	0	Patents	500	0	0
Sundry Creditors		3,652	0	0	Cash at Bank	784	0	0
	£	46,652	0	0	£	46,652	0	0

The results of the realisation were as follows: Freehold Factory, £26,450; Machinery and Plant, £8,924; Sundry Debtors, £7,395; Stock, £9,886; Patents, nil. The dissolution expenses amounted to £200. McArthur took over a motor-car (included in Machinery and Plant at £250) at an agreed price of £220. The accounts necessary to record the dissolution are as follows:—

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			Dr. £	s.	d.	Cr. £	s.	d.
19.. Dec 31	Realisation Account .. .. Dr.	21	45,868	0	0			
	To Sundry Assets:—							
	Freehold Factory	10				18,185	0	0
	Machinery and Plant	12				9,875	0	0
	Sundry Debtors	14				7,546	0	0
	Stock	16				9,462	0	0
	Patents	18				500	0	0
	Being transfer of these assets upon dissolution.							
,, 31	Cash .. .. Dr.	C.B. 19	52,655	0	0			
	To Realisation Account	22				52,655	0	0
	Being proceeds of sale of the above assets.							
,, 31	Realisation Account .. .. Dr.	21	200	0	0			
	To Cash	C.B. 20				200	0	0
	Being expenses of dissolution.							
,, 31	G. McArthur, Capital Account .. .. Dr.	1	220	0	0			
	To Realisation Account	22				220	0	0
	Being agreed value of motor taken over.							
,, 31	Realisation Account .. .. Dr.	21	6,807	0	0			
	To G. McArthur (Capital Account)	2				4,538	0	0
	,, C Testout (Capital Account)	4				2,269	0	0
	Being profit on realisation now transferred.							

LEDGER.

1 G. McArthur. Capital Account. **2**

Dr.			£	s.	d.				£	s.	d.
19.. Dec. 31	To Motor	J. 36	220	0	0	19.. Dec. 31	By Balance	√	30,000	0	0
,, 31	,, Balance carried down	√	34,318	0	0	,, 31	,, Realisation Account	J. 36	4,538	0	0
		£	34,538	0	0			£	34,538	0	0
19.. Dec. 31	To Cash	C.B. 20	34,318	0	0	19.. Dec. 31	By Balance brought down	√	34,318	0	0

3 C. Testout. Capital Account. **4**

Dr.			£	s.	d.				£	s.	d.
19.. Dec. 31	To Balance carried down	√	12,269	0	0	19.. Dec. 31	By Balance	√	10,000	0	0
						,, 31	,, Realisation Account	J. 36	2,269	0	0
		£	12,269	0	0			£	12,269	0	0
19.. Dec. 31	To Cash	C.B. 20	12,269	0	0	19.. Dec. 31	By Balance brought down	√	12,269	0	0

LEDGER—*continued.*

5 LOAN ACCOUNT. 6

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Cash	C.B. 20	3,000	0	0	19... Dec. 31	By Balance	√	3,000	0	0

7 SUNDRY CREDITORS. 8

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Cash	C.B. 20	3,652	0	0	19... Dec. 31	By Balance	√	3,652	0	0

9 FREEHOLD FACTORY. 10

Dr.			£	s.	d.				£	s.	d. Cr.
19.. Dec. 31	To Balance ..	√	18,485	0	0	19... Dec. 31	By Realisation Account	J. 36	18,485	0	0

11 MACHINERY AND PLANT. 12

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Balance ..	√	9,875	0	0	19... Dec. 31	By Realisation Account	J. 36	9,875	0	0

13 SUNDRY DEBTORS. 14

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Balance ..	√	7,546	0	0	19... Dec. 31	By Realisation Account	J. 36	7,546	0	0

15 STOCK. 16

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Balance ..	√	9,462	0	0	19... Dec. 31	By Realisation Account	J. 36	9,462	0	0

17 PATENTS. 18

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Balance ..	√	500	0	0	19... Dec 31	By Realisation Account	J. 36	500	0	0

LEDGER—*continued*

REALISATION ACCOUNT. 22

Dr.		J.	£	s.	d.			J.	£	s.	d. Cr.
19... Dec. 31	To Sundry Assets	36	45,868	0	0	19... Dec. 31	By Cash (Proceeds Sale of Assets)	36	52,655	0	0
" 31	" Cash (Dissolution Expenses)	36	200	0	0	" 31	" G. McArthur (Motor)	36	220	0	0
" 31	" Balance carried down	√	6,807	0	0						
		£	52,875	0	0			£	52,875	0	0
19... Dec. 31	To G. McArthur.		4,538	0	0	19.. Dec. 31	By Balance brought down	√	6,807	0	0
" 31	" C. Testout ..		2,269	0	0						
			£6,807	0	0				£6,807	0	0

19 CASH BOOK. 20

Dr.		J.	£	s.	d.			J.	£	s.	d. Cr.
19 .. Dec. 31	To Balance ..	√	784	0	0	19... Dec. 31	By Dissolution Expenses	36	200	0	0
31	" Cash, Proceeds Sale of Assets	J. 36	52,655	0	0	" 31	" Sundry Creditors	7	3,652	0	0
						" 31	" Loan	5	3,000	0	0
						" 31	" Cash—				
							G. McArthur ..	1	34,318	0	0
							C. Testout ..	3	12,269	0	0
		£	53,439	0	0			£	53,439	0	0

For examination purposes it would be equally correct to open the ledger accounts from the Balance Sheet figures, as shown above, and to present the Realisation Account as follows :—

REALISATION ACCOUNT.

(ALTERNATIVE METHOD.)

Dr.	£	s.	d.		£	s.	d. Cr.
To Transfer from Sundry Asset Accounts (loss on realisation) :— Machinery and Plant .. £701; Motor Car .. .. .. 30; Sundry Debtors .. .. 151; Patents 500	1,382	0	0	By Transfer from Sundry Asset Accounts (profit on sale) :— Freehold Factory £7,965; Stock 424	8,389	0	0
" Cash. Expenses of dissolution	200	0	0				
" Balance carried down	6,807	0	0				
£	8,389	0	0	£	8,389	0	0
To G. McArthur, Share of Profit ..	4,538	0	0	By Balance brought down	6,807	0	0
C. Testout, Share of Profit ..	2,269	0	0				
£	6,807	0	0	£	6,807	0	0

DR. CASH BOOK. CR

19..			£	s.	d.	19..			£	s.	d.
Dec. 31	To Balance		784	0	0	Dec. 31	By Dissolution Expenses		200	0	0
" 31	" Cash Proceeds Sale of Sundry Assets:					" 31	" Sundry Creditors..		3,652	0	0
	Freehold Factory		26,450	0	0	" 31	" Loan		3,000	0	0
	Machinery and Plant		8,924	0	0	" 31	" Cash. G. McArthur		34,318	0	0
	Sundry Debtors..		7,395	0	0	" 31	" Cash. C. Testout		12,269	0	0
	Stock		9,886	0	0						
		£	53,439	0	0			£	53,439	0	0

EXAMINATION QUESTION.

X, Y, and Z are partners and share profits as follows: X, ten twenty-fourths; Y, nine twenty-fourths; Z, five twenty-fourths.

X retired, as on December 31, 19.., at which date the Balance Sheet of the firm was as stated below:—

BALANCE SHEET, DECEMBER 31, 19..

		£		£
Capital—			Goodwill	10,000
X	£10,000		Machinery	8,760
Y	7,000		Sundry Assets	10,354
Z	5,000			
		22,000		
Current Accounts—				
X	£1,084			
Y	327			
Z	871			
		2,282		
Creditors		4,832		
		£29,114		£29,114

Under the partnership agreement, all assets and liabilities were to be taken at book values, with the exception of (*a*) Goodwill, which was to be valued at three times the average profits of the three years preceding the retirement, and (*b*) Machinery, which was to be re-valued by an independent valuer. The profits of the three years prior to the retirement were: First year, £3,742; second year, £5,641; third year, £1,472. The expert valuation of the machinery was £9,875. Prepare accounts showing the amount due to X on his retirement. (*Royal Society Arts.*)

Solution.

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
	Goodwill Account .. .. Dr.	855	0	0			
	To Realisation Account				855	0	0
	Being increase in the valuation of goodwill, i.e. three times the average profits = £10,855.						
	Machinery Account .. .. Dr.	1,115	0	0			
	To Realisation Account				1,115	0	0
	Being increase in the valuation of this asset.						
	Realisation Account .. .. Dr.	1,970	0	0			
	To X. Capital Account				820	16	8
	" Y. Capital Account				738	15	0
	" Z. Capital Account				410	8	4
	Being the partners' shares of the profit on the revaluations.						

X, Y & Z.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Goodwill	10,855	0	0
Y	£7,738 15 0				Machinery	9,875	0	0
Z	5,410 8 4				Sundry Assets	10,354	0	0
		13,149	3	4				
Current Accounts:—								
Y	327 0 0							
Z	871 0 0							
		1,198	0	0				
X. Balance of Capital Account	10,820 16 8							
X. Balance of Current Account	1,084 0 0							
		11,904	16	8				
Creditors		4,832	0	0				
	£	31,084	0	0	£	31,084	0	0

Dissolution and Division of Assets.—In some cases, on the retirement of a partner, the remaining partners decide to separate and dissolve the old firm, one or more of them agreeing to take over the assets upon agreed terms.

Illustration.—Deeds, Tape, and Parchment are in partnership as solicitors. Profits are shared in the proportions respectively of one-half, one-fourth, and one-fourth. Deeds retired on December 31, 19.., and Tape and Parchment decided to practise separately—Tape taking over the general, and Parchment the parliamentary practice. The Balance Sheet on the date of dissolution was as follows:—

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.			£	s.	d.
Capital:—					Lease of Offices		1,250	0	0
Deeds	£10,000				Furniture and Fittings		875	0	0
Tape	8,000				Sundry Debtors:—				
Parchment	6,800				General	£9,950			
		24,800	0	0	Parliamentary	8,420			
Creditors		5,378	0	0			18,370	0	0
					Cash at Bank		9,683	0	0
	£	30,178	0	0		£	30,178	0	0

The agreed terms of dissolution were that Deeds was to be credited with £6,000 as representing the value of his share of the goodwill, and that this sum was to be provided in equal shares by Tape and Parchment. Tape was to take over the lease of the offices at £1,000, the Furniture and Fittings at £750, and the general debtors at £9,500. Parchment was to take over the parliamentary debtors at £8,000. Discounts amounting to £23 were secured on payment of the creditors. The dissolution expenses were £250.

Dr. CASH BOOK. Cr.

19...			£	s.	d.	19...			£	s.	d.
Dec. 31	To Balance		9,683	0	0	Dec. 31	By Creditors		5,355	0	0
,, 31	,, Cash, Tape		6,618	0	0	,, 31	,, Expenses of Dissolution		250	0	0
,, 31	,, Cash, Parchment		4,568	0	0	,, 31	,, Cash, Deeds, Balance of Capital Account		15,264	0	0
		£	20,869	0	0			£	20,869	0	0

REALISATION ACCOUNT.

Dr.		£	s.	d.	Cr.		£	s.	d.
19.. Dec. 31	To Loss on Realisation:—				19.. Dec. 31	By Discount on Sundry Creditors	23	0	0
	Lease of Offices ..	250	0	0	,, 31	,, Balance carried down	1,472	0	0
	Furniture and Fittings	125	0	0					
	General Debtors	450	0	0					
	Parliamentary Debtors	420	0	0					
,, 31	,, Expenses of Dissolution	250	0	0					
		£1,495	0	0			£1,495	0	0
19.. Dec. 31	To Balance brought down	1,472	0	0	19.. Dec 31	By Deeds, ½ Share of Loss	736	0	0
					,, 31	,, Tape, ¼ Share of Loss	368	0	0
					,, 31	,, Parchment, ¼ Share of Loss	368	0	0
		£1,472	0	0			£1,472	0	0

DEEDS. CAPITAL ACCOUNT.

Dr.		£	s.	d.	Cr.		£	s.	d.
19.. Dec. 31	To Share of Loss on Realisation ..	736	0	0	19.. Dec. 31	By Balance..	10,000	0	0
,, 31	,, Balance carried down	15,264	0	0	,, 31	,, Goodwill	6,000	0	0
		£16,000	0	0			£16,000	0	0
19.. Dec. 31	To Cash	15,264	0	0	19.. Dec. 31	By Balance brought down	15,264	0	0
		£15,264	0	0			£15,264	0	0

TAPE. CAPITAL ACCOUNT.

Dr.		£	s.	d.	Cr.		£	s.	d.
19.. Dec. 31	To Share of Loss on Realisation ..	368	0	0	19.. Dec. 31	By Balance..	8,000	0	0
31	,, Half Share of Deeds's Goodwill	3,000	0	0	,, 31	,, Balance carried down	6,618	0	0
,, 31	,, Lease of Offices ..	1,000	0	0					
,, 31	,, Furniture and Fittings	750	0	0					
,, 31	,, General Debtors	9,500	0	0					
		£14,618	0	0			£14,618	0	0
19.. Dec. 31	To Balance brought down	6,618	0	0	19.. Dec. 31	By Cash	6,618	0	0
		£6,618	0	0			£6,618	0	0

PARCHMENT. CAPITAL ACCOUNT.

Dr.		£	s.	d.			£	s.	d. Cr.
19... Dec. 31	To Share of Loss on Realisation ..	368	0	0	19... Dec. 31	By Balance	6,800	0	0
" 31	" Half Share of Deeds's Goodwill	3,000	0	0	" 31	" Balance carried down	4,568	0	0
" 31	" Parliamentary Debtors	8,000	0	0					
		£ 11,368	0	0			£ 11,368	0	0
19... Dec. 31	To Balance brought down	4,568	0	0	19... Dec. 31	By Cash	4,568	0	0
		£4,568	0	0			£4,568	0	0

Note.—The student will realise that for this arrangement to be fair the Goodwill of the two branches of the practice must be substantially equal in value.

Distribution of Assets in Specie.—Where the partners cannot agree upon the value to be assigned to certain assets which cannot readily or conveniently be realised, the book value should, in the absence of agreement, be transferred to the debit of the partner's Capital Accounts in the proportion in which they share profits or losses.

Illustration.—A and B have capitals of £900 and £600, and share profits as to one-fourth and three-fourths, respectively. The assets include 400 shares of doubtful value, which appear in the books at cost, i.e. £300. They ask your advice as to the proper treatment of this asset upon dissolution, as they are unable to agree. State your proposals.

Answer.—Assuming each share to be of the same class, the asset account should be closed off by transferring £75 to the debit of A's Capital Account, and £225 to the debit of B's Capital Account, the shares being transferred into the names of the individual partners, i.e. 100 to A and 300 to B, or being held for them in that proportion. By such means the holding of each partner becomes rateable to his interest in the shares, for it is then immaterial whether they are worth more or less than the book value, or whether a profit or loss ultimately results.

Dissolution and Revaluation of Assets.

Illustration.—H. Dickson, J. B. Clarke, and G. Macdonald were partners, sharing profits in the proportions one-half, one-third, and one-sixth respectively. The Balance Sheet of the firm at December 31, 19.., was as follows :—

Dickson, Clarke & Macdonald.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital :—					Freehold Factory	10,000	0	0
H. Dickson	£12,000				Machinery and Plant	5,741	0	0
J. B. Clarke	7,000				Loose Tools	744	0	0
G. Macdonald	3,500				Motor Vans	3,462	0	0
		22,500	0	0	Stock	4,878	0	0
Sundry Creditors		1,440	0	0	Sundry Debtors	3,641	0	0
Bills Payable		800	0	0	Cash at Bank	2,274	0	0
Loan (secured by mortgage on Freehold Factory)		6,000	0	0				
		£ 30,740	0	0		£ 30,740	0	0

Dickson retired as on January 1st following the above Balance Sheet. The business was taken over by Clarke and Macdonald on the following terms :—

(*a*) The assets were to be revalued as follows: Freehold Factory, £12,000; Machinery and Plant was to be depreciated by 20 %, and Loose Tools by 33⅓ %; Motor Vans, £2,200; Stock, £5,000. Provision for bad debts was agreed at £300.

(*b*) The liabilities were taken over at the Balance Sheet values, and discount amounting to £102 was secured when paying the creditors. One quarter's interest on the Mortgage at 5 % had been omitted from the Balance Sheet.

(*c*) Goodwill was to be valued at £8,000.

(*d*) Of the amount due to Dickson on retirement, £5,000 was to be left in the business as a loan at 5 %, and the balance was to be paid out over a term of ten years in equal instalments beginning June 30th next after the retirement.

(*e*) Clarke and Macdonald were to pay the expenses connected with the retirement, and these amounted to £100.

Prepare (1) the Journal entries, (2) the Realisation Account and other Ledger accounts recording the above particulars in the books of the old firm as on January 1, 19.., assuming that the transactions had been completed on that date. Assume also that the Sundry Creditors were paid off in cash, and that the Mortgage on the Factory and the Bills Payable remain on the books as shown in the above Balance Sheet.

16 JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19.. Dec. 31	Sundries Dr.							
	To Realisation Account	2				2,122	0	0
	Freehold Factory	11	2,000	0	0			
	Stock	15	122	0	0			
	Being appreciation of these assets.							
„ 31	Realisation Account Dr.	1	2,958	4	0			
	To Sundries :—							
	Plant and Machinery	14				1,148	4	0
	Loose Tools	18				248	0	0
	Motor Vans	20				1,262	0	0
	Sundry Debtors (Provision)	22				300	0	0
	Being depreciation of these assets and provision for bad debts.							
„ 31	Goodwill Dr.	31	8,000	0	0			
	To Realisation Account	2				8,000	0	0
	Being agreed value of this asset.							
„ 31	Realisation Account Dr.	1	75	0	0			
	To Mortgage Interest	34				75	0	0
	Being one quarter's interest at 5 % per annum on £6,000 accrued due.							
„ 31	Discount Account Dr.	27	102	0	0			
	To J. B. Clarke, Capital Account	10				68	0	0
	„ G. Macdonald, Capital Account	4				34	0	0
	Being profit (discount) on discharge of creditors.							

LEDGER.

Realisation Account.

1 Dr. | Cr. 2

Date	Particulars	J.	£	s.	d.	£	s.	d.	Date	Particulars	J.	£	s.	d.	£	s.	d.
19... Dec. 31	To Depreciation :—								19... Dec. 31	By Freehold Property (Appreciation)	16				2,000	0	0
" 31	Plant and Machinery	16	1,148	4	0				" 31	" Stock (Appreciation)	16				122	0	0
" 31	Loose Tools		248	0	0				" 31	" Goodwill	16				8,000	0	0
" 31	Motor Vans		1,262	0	0												
" 31	Sundry Debtors		300	0	0	2,958	4	0									
" 31	" Mortgage Interest accrued	16				75	0	0									
" 31	" Balance carried down	√				7,088	16	0									
					£	10,122	0	0						£	10,122	0	0
19... Dec. 31	To H. Dickson, Capital Account ..	8				3,544	8	0	19... Dec. 31	By Balance brought down..	√				7,088	16	0
" 31	" J. B. Clarke, Capital Account ..	10				2,362	18	8									
" 31	" G. Macdonald, Capital Account ..	4				1,181	9	4									
						£7,088	16	0							£7,088	16	0

G. Macdonald. Capital Account.

3 Dr. | Cr. 4

Date	Particulars	C.B.	£	s.	d.	Date	Particulars		£	s.	d.
19... Dec. 31	To Share of Cost of Realisation	30	33	6	8	19... Dec. 31	By Balance	√	3,500	0	0
" 31	" Balance carried down	√	4,648	2	8	" 31	" Share of Profit on Realisation	1	1,181	9	4
			£4,681	9	4				£4,681	9	4
19... an. 1	To Balance carried down	√	4,682	2	8	19... Jan. 1	By Balance brought down	√	4,648	2	8
						" 1	" Profit on discnarge of Creditors.	J.16	34	0	0
			£4,682	2	8				£4,682	2	8
						Jan. 1	By Balance brought down..	7	4,682	2	8

LEDGER—*continued.*

5 Dr. HUGH DICKSON. LOAN ACCOUNT. **Cr. 6**

Date		Fo.	£	s.	d.	Date		Fo.	£	s.	d.
						19... Jan. 1	By Transfer from Capital Account	7	5,000	0	0

7 Dr. HUGH DICKSON. CAPITAL ACCOUNT. **Cr. 8**

Date		Fo.	£	s.	d.	Date		Fo.	£	s.	d.
19... Dec. 31	To Balance carried down	√	15,544	8	0	19... Dec. 31	By Balance	√	12,000	0	0
						„ 31	„ Share of Profit on Realisation	1	3,544	8	0
		£	15,544	8	0			£	15,544	8	0
19... Jan. 1	To Transfer to Loan Account	6	5,000	0	0	19... Dec 31	By Balance brought down	√	15,544	8	0
„ 1	„ Balance carried down	√	10,544	8	0						
		£	15,544	8	0			£	15,544	8	0
						19... Jan. 1	By Balance brought down..	√	10,544	8	0

9 Dr. J. B. CLARKE. CAPITAL ACCOUNT. **Cr. 10**

Date		Fo.	£	s.	d.	Date		Fo.	£	s.	d.
19... Dec. 31	To Share of Cost of Realisation	C.B. 30	66	13	4	19... Dec 31	By Balance	√	7,000	0	0
„ 31	„ Balance carried down	√	9,296	5	4	„ 31	„ Share of Profit on Realisation	1	2,362	18	8
			£9,362	18	8				£9,362	18	8
19... Jan. 1	To Balance carried down	√	9,364	5	4	19... Jan. 1	By Balance brought down..	√	9,296	5	4
						„ 1	„ Profit on discharge of Creditors	J.16	68	0	0
			£9,364	5	4				£9,364	5	4
						19... Jan. 1	By Balance brought down..	√	9,364	5	4

LEDGER—*continued*.

11 FREEHOLD FACTORY. 12

DR. CR.

			£	s.	d.				£	s.	d.
19... Dec 31	To Balance ..	✓	10,000	0	0	19... Dec 31	By Balance carried down	✓	12,000	0	0
" 31	" Realisation Account	J. 16	2,000	0	0						
		£	12,000	0	0			£	12,000	0	0
19... Jan. 1	To Balance brought down		12,000	0	0						

13 MACHINERY AND PLANT. 14

DR. CR.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance ..	✓	5,741	0	0	19... Dec 31	By Realisation Account	J. 16	1,148	4	0
						" 31	" Balance carried down .. .	✓	4,592	16	0
			£5,741	0	0				£5,741	0	0
19... Jan. 1	To Balance brought down	✓	4,592	16	0						

15 STOCK. 16

DR. CR.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance ..	✓	4,878	0	0	19... Dec. 31	By Balance carried down	✓	5,000	0	0
" 31	" Realisation Account	J. 16	122	0	0						
			£5,000	0	0				£5,000	0	0
19... Jan. 1	To Balance brought down	✓	5,000	0	0						

17 LOOSE TOOLS. 18

DR. CR.

			£	s	d.			J.	£	s.	d.
19... Dec. 31	To Balance ..	✓	744	0	0	19... Dec. 31	By Realisation Account	16	248	0	0
						" 31	" Balance carried down	✓	496	0	0
			£744	0	0				£744	0	0
19... Jan. 1	To Balance brought down	✓	496	0	0						

LEDGER—*continued.*

19 Motor Vans. 20

Dr.			£	s.	d.	Cr.		J.	£	s.	d.
19... Dec. 31	To Balance ..	√	3,462	0	0	19... Dec. 31	By Realisation Account	16	1,262	0	0
						" 31	" Balance carried down	√	2,200	0	0
			£3,462	0	0				£3,462	0	0
19... Jan. 1	To Balance brought down	√	2,200	0	0						

21 Sundry Debtors. 22

Dr.			£	s.	d	Cr.		J.	£	s.	d.
19... Dec. 31	To Balance ..	√	3,641	0	0	19... Dec. 31	By Realisation Account	16	300	0	0
						" 31	" Balance carried down	√	3,341	0	0
			£3,641	0	0				£3,641	0	0
19... Jan. 1	To Balance brought down	√	3,341	0	0						

23 Sundry Creditors. 24

Dr.			£	s.	d.	Cr.			£	s.	d.
19... Dec. 31	To Cash and Discount	C.B. 30	1,440	0	0	19... Dec. 31	By Balance	√	1,440	0	0
			£1,440	0	0				£1,440	0	0

25 Bills Payable. 26

Dr.			£	s.	d	Cr.			£	s.	d.
						19... Dec. 31	By Balance	√	800	0	0

27 Discount Account. 28

Dr.			£	s.	d.	Cr.		C.B.	£	s.	d.
19... Dec. 31	To J. B. Clarke, Capital Account		68	0	0	19... Dec. 31	By Sundries	30	102	0	0
" 31	" G. Macdonald, Capital Account		34	0	0						
		√	£102	0	0				£102	0	0

LEDGER—*continued*

CASH BOOK.

29 DR. | CR. 30

Date			Discount £	s.	d.	Bank £	s.	d.	Date			Discount £	s.	d.	Bank £	s.	d.
19... Dec. 31	To Balance	√				2,274	0	0	19.. Dec. 31	By Sundry Creditors	23	102	0	0	1,338	0	0
									„ 31	„ Expenses of Realisation:—							
										J. B. Clarke .. £66 13 4	9						
										G. Macdonald . 33 6 8	3				100	0	0
									„ 31	„ Balance carried down	√				836	0	0
						£2,274	0	0				£102	0	0	£2,274	0	0
19... Jan. 1	To Balance brought down	√				836	0	0									

GOODWILL.

31 DR. | CR. 32

Date		J.	£	s.	d.	Date			£	s.	d.
19... Dec. 31	To Realisation Account	16	8,000	0	0						

MORTGAGE INTEREST.

33 DR. | CR. 34

Date			£	s	d.	Date		J	£	s	d.
						19.. Dec 31	By Realisation Account	16	75	0	0

Clarke & Macdonald.

BALANCE SHEET, JANUARY 1, 19...

	£ s. d.	£	s.	d.			£	s.	d.
Capital—					Goodwill		8,000	0	0
J. B. Clarke	9,364 5 4				Freehold Factory		12,000	0	0
G. Macdonald	4,682 2 8				Machinery and Plant		4,592	16	0
		14,046	8	0	Loose Tools		496	0	0
Sundry Creditors—					Motor Vans		2,200	0	0
H. Dickson	10,544 8 0				Stock		5,000	0	0
Bills Payable	800 0 0				Sundry Debtors ..	£3,641 0 0			
		11,344	8	0	*Less* Reserve for Bad				
H. Dickson, Loan Account		5,000	0	0	Debts	300 0 0			
Mortgage	6,000 0 0						3,341	0	0
Mortgage Interest accrued ..	75 0 0				Cash at Bank		836	0	0
		6,075	0	0					
	£	36,465	16	0		£	36,465	16	0

NOTE.—Goodwill. If Clarke and Macdonald decided that they did not want a figure of Goodwill in the Balance Sheet, they could :—

(*a*) Credit Goodwill £8,000, and debit their Capital Accounts in proportion (2 and 1).

(*b*) They could have omitted it entirely from the Realisation Account, merely crediting Dickson's Capital Account with his share (£4,000) and debiting the like amount to their own Capital Accounts in proportion (2 and 1).

Dissolution. Writing Back Reserves and Revaluation.

Illustration.—X, Y, and Z own in partnership a fleet of steamers. They share profits as follows: X, one-half; Y, one-third; Z, one-sixth. X holds £40,000 of the capital, Y, £18,000, and Z, £14,000. X retired from the firm as on December 31, 19... According to the partnership deed, goodwill was to be valued on the death or retirement of a partner at an amount equal to the average of the profits of the three years preceding retirement or death. The profits for the first year, coming into average, were £14,782; for the second year there was a loss of £4,287; and for the third year a profit of £20,189. The average profits were therefore:—

	£
First year, profit	14,782
Third year, profit £20,189, less Loss on Stores (see below), £684	19,505
	34,287
Less Second year, loss	4,287
	3)30,000
Average profit	£10,000

The Balance Sheet of the firm on December 31, 19.., the date of X's retirement, was as follows:—

X, Y & Z.

BALANCE SHEET, DECEMBER 31, 19...

Dr.		£	s.	d.	Cr.	£	s.	d
Capital:—					Steamships (*Rose*, *Tulip*, and *Aster*)	94,656	0	0
X	£40,000				Leasehold Wharf	9,684	0	0
Y	18,000				Stores, Coal, etc.	8,684	0	0
Z	14,000							
		72,000	0	0	Lighters and Launch	2,178	0	0
Current Accounts:—					Sundry Debtors	12,641	0	0
X	5,872				Cash at Bank	5,620	0	0
Y	3,242							
Z	1,874							
		10,988	0	0				
Marine Insurance Fund		18,250	0	0				
Reserve for Bad Debts		1,000	0	0				
Loan from Bank		12,500	0	0				
Sundry Creditors		17,975	0	0				
Suspense Account		750	0	0				
	£	133,463	0	0	£	133,463	0	0

It had been the firm's practice to underwrite a portion of their marine risks by charging an annual sum to Profit and Loss Account. It was agreed that the marine risks represented by the accumulated fund standing in the Balance Sheet had expired. It was also agreed that (*a*) the reserve for bad debts was £350 in excess of requirements; (*b*) the Suspense Account, created to complete a claim now abandoned, should be written back. The following revaluations were also agreed: Steamships, £90,000; Leasehold Wharf, £12,742; Stores, etc., £8,000; Lighters, etc., £2,000. Dissolution expenses were £200. The Realisation (or Revaluation) Account is as follows:—

REALISATION ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
19... Dec. 31	To Depreciations as agreed :—				19.. Dec. 31	By Marine Insurance Fund, written back	18,250	0	0
	Steamships ..	4,656	0	0	,, 31	,, Suspense Account, written back ..	750	0	0
	Stores	684	0	0	,, 31	,, Excess provision for Bad Debts, written back	350	0	0
	Lighters, etc. ..	178	0	0	,, 31	,, Appreciation in value of Wharf ..	3,058	0	0
,, 31	,, Expenses of Dissolution	200	0	0	,, 31	,, Goodwill, average profit of last 3 years	10,000	0	0
,, 31	,, Balance carried down	26,690	0	0					
		£32,408	0	0			£32,408	0	0
19... Dec. 31	To X, ½ Share	13,345	0	0	19... Dec 31	By Balance brought down	26,690	0	0
,, 31	,, Y, ⅓ Share	8,896	13	4					
,, 31	,, Z, ⅙ Share	4,448	6	8					
		£26,690	0	0			£26,690	0	0

The amount to be paid out to X on completion of the dissolution would therefore be :—

X. CAPITAL ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
19... Dec. 31	To Balance carried down	59,217	0	0	19.. Dec. 31	By Balance..	40,000	0	0
					,, 31	,, Transfer from Realisation Account ..	13,345	0	0
					,, 31	,, Transfer from Current Account ..	5,872	0	0
		£59,217	0	0			£59,217	0	0
					19 .. Dec. 31	By Balance brought down	59,217	0	0

Y and Z, the continuing partners, may prefer to revert to the financial position prior to the retirement of X in so far as Goodwill and the Marine Insurance Fund are concerned. If so, the entries made for the purpose of X's retirement can be reversed as follows :—

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		Dr. £	s.	d.	Cr. £	s.	d.
19... Jan. 1	Sundries :— Dr.						
	Y, Capital Account	12,750	0	0			
	Z, Capital Account	6,375	0	0			
	To Goodwill Account				10,000	0	0
	,, Marine Insurance Fund				9,125	0	0*
	Being reversal of entries in Realisation Account dated December 31, 19...						

* This represents Y or Z's proportion of the Fund.

The revaluation of the assets can also be reversed, or again revised, in a similar manner, if desired.

Dissolution by Death. Interest in Lieu of Profits.—Some deeds of partnership provide that upon the death of a partner the representatives of the deceased shall be paid interest at a fixed rate upon the deceased partner's capital from the date of the last Balance Sheet to the day of death. This interest is in lieu of any share in the profits which may have accrued, and is usually fixed at a higher rate than is allowed on capital in the ordinary course. Such an agreement obviates the necessity of preparing special accounts up to the date of death, but it may, of course, operate harshly as between the surviving partner and the representatives of the deceased partner if abnormal profits or losses have occurred since the date of the last Balance Sheet prior to the death.

Illustration.—A, B, and C are partners and share profits in the proportion one-half, one-fourth, and one-fourth respectively. On December 31, 19.., the date of the last Balance Sheet, the Capital Accounts stood as follows: A, £10,000; B, £8,500; C, £8,000. On March 31st following, the credit balances of the Current Accounts were: A, £952; B, £786; C, £810. It was provided by the partnership deed that, in the event of a partner's death, interest at the rate of 8 % per annum was to be allowed from the date of the last Balance Sheet to the date of death, in lieu of a share of profits for the same period. Goodwill was to be valued at one year's purchase of the average of the profits for the three years ended on the date of the last Balance Sheet prior to the death. The profits for these years were: £7,896, £3,274, and £6,842, the average therefore being £6,004. A died on March 31, 19... The amount payable to the representatives of A would appear in his Capital Account as follows:—

A. CAPITAL ACCOUNT.

Dr.			£	s.	d.		Cr.		£	s.	d.
19... Mar. 31	To Balance carried down		14,154	0	0	19... Dec. 31	By Balance..		10,000	0	0
						Mar. 31	,, Transfer from Current Account ..		952	0	0
						,, 31	,, Interest on £10,000 at 8 % for 3 months*		200	0	0
						,, 31	,, Share of Goodwill (half)		3,002	0	0
		£	14,154	0	0			£	14,154	0	0
						19.. Mar. 31	By Balance brought down		14,154	0	0

* It might be contended that this Interest should be based not on £10,000 but on the agreed amended capital, i.e. £13,954.

Loss on Dissolution.—By way of further illustration, a problem resulting in a loss upon dissolution may prove useful. The journal and ledger entries are identical in principle with those already dealt with in the preceding illustrations, and need not be repeated *in extenso*

Illustration.—B. Uprichard and L. Inchiquin are equal partners Trading having proved unsuccessful for the past few years, they decide to wind up the business as on December 31, 19... At that date their Balance Sheet was as follows:—

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.			£	s.	d.
Capital :—					Leasehold Warehouse		8,241	0	0
B. Uprichard	£10,000				Machinery and Plant		4,110	0	0
L. Inchiquin	8,000				Stock		5,821	0	0
		18,000	0	0	Sundry Debtors	£6,420			
Sundry Creditors		4,490	0	0	*Less* Reserve for Bad				
Loan from Bank		2,000	0	0	Debts	321			
							6,099	0	0
					Cash in hand		219	0	0
	£	24,490	0	0		£	24,490	0	0

The assets were realised with the following results: Leasehold Warehouse, £7,850; Machinery and Plant, £3,320; Stock, £5,996; Sundry Debtors, £5,997. The goodwill, name, and trade marks of the firm were sold for £200. The expenses of dissolution were £150. When settling with the creditors, it was found that a debt of £50 had been omitted from the above Balance Sheet. Dealing with this problem upon the alternative method already illustrated, the more important accounts would appear as follows :—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Realisation Account .. .. Dr.		1,604	0	0			
	To Sundry Assets :—							
	Leasehold Warehouse					391	0	0
	Machinery and Plant					790	0	0
	Sundry Debtors					423	0	0
	Being transfer of the losses on sale of these assets.							
" 31	Stock .. .. Dr.		175	0	0			
	To Realisation Account					175	0	0
	Being transfer of the profit on the sale of this asset.							
" 31	Reserve for Bad Debts .. .. Dr.		321	0	0			
	To Realisation Account					321	0	0
	Being transfer of balance of this reserve account.							

1 CASH BOOK. 2

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance ..	√	219	0	0	19... Dec. 31	By Sundry Creditors	√	4,490	0	0
" 31	" *Cash Proceeds* realisation of Sundry Assets :					" 31	" *Loan from Bank*	√	2,000	0	0
	Leasehold Warehouse ..	10	7,850	0	0	" 31	" Expenses of Dissolution	3	150	0	0
	Machinery and Plant	√	3,320	0	0	" 31	" Liability omitted from Balance Sheet	3	50	0	0
	Stock	√	5,996	0	0	" 31	" Cash. B. Uprichard	5	9,446	0	0
	Sundry Debtors	√	5,997	0	0	" 31	" Cash. L. Inchiquin	7	7,446	0	0
" 31	" Cash. Proceeds Sale of Goodwill, etc. ..	4	200	0	0						
		£	23,582	0	0			£	23,582	0	0

LEDGER.

3 Realisation Account. 4

Dr.					Cr.				
	J.	£	s.	d.		J.	£	s.	d.
To Loss on Realisation of — Leasehold Warehouse ..	16	391	0	0	By Profit on Realisation of Stock	16	175	0	0
Machinery and Plant	—	790	0	0	" Reserve for Bad Debts	—	321	0	0
Sundry Debtors	—	423	0	0	" Proceeds Sale of Goodwill ..	C.B. 1	200	0	0
" Expenses of Realisation ..	C.B. 1	150	0	0	" Balance carried down .. .	√	1,108	0	0
" Liability omitted from Balance Sheet ..	2	50	0	0					
		£1,804	0	0			£1,804	0	0
To Balance brought down	√	1,108	0	0	By B. Uprichard ..	5	554	0	0
					" L. Inchiquin ..	7	554	0	0
		£1,108	0	0			£1,108	0	0

5 B. Uprichard. Capital Account. 6

Dr.						Cr.					
			£	s.	d				£	s.	d
19... Dec. 31	To Realisation Account	4	554	0	0	19... Dec. 31	By Balance.. ..	√	10,000	0	0
" 31	" Balance carried down	√	9,446	0	0						
		£	10,000	0	0			£	10,000	0	0
19... Dec. 31	To Cash	C.B. 2	9,446	0	0	19... Dec. 31	By Balance brought down	√	9,446	0	0

7 L. Inchiquin. Capital Account. 8

Dr.						Cr.					
			£	s.	d.				£	s.	d.
19... Dec. 31	To Realisation Account	4	554	0	0	19... Dec. 31	By Balance	√	8,000	0	0
" 31	" Balance carried down	√	7,446	0	0						
			£8,000	0	0				£8,000	0	0
19... Dec. 31	To Cash	C.B. 2	7,446	0	0	19... Dec 31	By Balance brought down	√	7,446	0	0

9 Leasehold Warehouse. 10

Dr.						Cr.					
			£	s.	d				£	s.	d.
19... Dec. 31	To Balance ..	√	8,241	0	0	19... Dec. 31	By Cash	C.B. 1	7,850	0	0
						" 31	" Realisation Account		391	0	0
			£8,241	0	0				£8,241	0	0

The remaining asset accounts duplicate the Leasehold Warehouse Account given above.

EXAMINATION QUESTION.

A, B, and C carried on business in partnership, and on December 31st their Balance Sheet was as follows :—

Liabilities.	£	Assets.	£
Sundry Creditors	4,500	Land and Buildings	4,000
A, Loan	6,000	Plant and Machinery ..	8,000
Capital Accounts—		Loose Plant and Tools ..	1,500
A	12,000	Stock in Trade	10,000
B	10,000	Sundry Debtors	14,000
C	7,500	Cash at Bank and in hand	2,500
	£40,000		£40,000

They decide to dissolve the partnership as at December 31st. A retires, and B and C carry on the business, and agree to purchase A's share in the capital of the firm in the proportions in which they share profits and losses. Profits and losses are shared : A, two-fifths ; B, two-fifths ; C, one-fifth. A agrees to allow his loan to remain in the business.

For the purposes of the dissolution, the Goodwill is valued at £5,000, and the assets are to be taken as follows : Land and Buildings, £4,500 ; Plant and Machinery as in the Balance Sheet, subject to 10 % depreciation ; Loose Plant and Tools as in the Balance Sheet ; Stock-in-Trade at £9,000 ; Sundry Debtors as in the Balance Sheet, subject to £1,158 provision for bad debts and an allowance of 5 % for discounts and costs of collection (calculate to nearest £).

The liability to Sundry Creditors is taken over by B and C, subject to an allowance of £200 for discounts.

B and C continue to share profits and losses in the same proportions as heretofore.

Draw up the Realisation Account, the Ledger Accounts, and the Balance Sheet of B and C as on January 1st next. (*Chartered Accountants—Final.*)

Solution.

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		Dr. £	s.	d.	Cr. £	s.	d.
Realisation Account .. .. Dr.	1	3,600	0	0			
To Sundry Assets :—							
Plant and Machinery (10 % Depreciation ..	14				800	0	0
Sundry Debtors (Provision for Bad Debts) ..	20				1,158	0	0
Sundry Debtors (Discounts and Costs)					642	0	0
Stock	18				1,000	0	0
Being transfer of the losses on these assets.							
Land and Buildings .. .. Dr.	11	500	0	0			
To Realisation Account	2				500	0	0
Being transfer of the profit on this asset.							
Goodwill Account .. .. Dr.	9	5,000	0	0			
To A	4				2,000	0	0
„ B	6				2,000	0	0
„ C	8				1,000	0	0
Being share of the valuation of Goodwill							
Sundry Creditors .. .. Dr.	25	200	0	0			
To Realisation Account	2				200	0	0
Being reserve for discounts, etc.							

LEDGER.

1 REALISATION ACCOUNT. 2

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Loss on Realisation of :— Plant and Machinery	24	800	0	0	19... Dec. 31	By Profit on Land and Buildings ..	24	500	0	0
	Sundry Debtors	—	1,800	0	0	,, 31	,, Reserve for Discounts, etc., on Sundry Creditors	24	200	0	0
	Stock	—	1,000	0	0	,, 31	,, Balance carried down	√	2,900	0	0
			£3,600	0	0				£3,600	0	0
19... Dec. 31	To Balance brought down	√	2,900	0	0	19... Dec. 31	By A, 2/5 loss	3	1,160	0	0
						,, 31	,, B, 2/5 loss	5	1,160	0	0
						,, 31	,, C, 1/5 loss	7	580	0	0
			£2,900	0	0				£2,900	0	0

3 A. CAPITAL ACCOUNT. 4

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Loss on Realisation	2	1,160	0	0	19... Dec. 31	By Balance	√	12,000	0	0
,, 31	,, Balance transferred :—					,, 31	,, Share of Goodwill	J. 24	2,000	0	0
	B, two-thirds	6	8,560	0	0						
	C, one-third ..	8	4,280	0	0						
		£	14,000	0	0			£	14,000	0	0

5 B. CAPITAL ACCOUNT. 6

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Loss on Realisation	2	1,160	0	0	19... Dec. 31	By Balance	√	10,000	0	0
31	,, Balance carried down	√	19,400	0	0	,, 31	,, Share of Goodwill	J. 24	2,000	0	0
						,, 31	,, Transfer from A's Capital Account	3	8,560	0	0
		£	20,560	0	0			£	20,560	0	0
						19... Dec. 31	By Balance brought down	√	19,400	0	0

7 C. CAPITAL ACCOUNT. 8

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Loss on Realisation	2	580	0	0	19... Dec. 31	By Balance	√	7,500	0	0
,, 31	,, Balance carried down	√	12,200	0	0	,, 31	,, Share of Goodwill	J. 24	1,000	0	0
						,, 31	,, Transfer from A's Capital Account	3	4,280	0	0
		£	12,780	0	0			£	12,780	0	0
						19... Dec. 31	By Balance brought down	√	12,200	0	0

LEDGER—*continued.*

9 GOODWILL ACCOUNT. 10

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Sundries	J 24	5,000	0	0						

11 LAND AND BUILDINGS. 12

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Balance	√	4,000	0	0	19... Dec 31	By Balance carried down	√	4,500	0	0
,, 31	,, Realisation Account	J. 24	500	0	0						
			£4,500	0	0				£4,500	0	0
19... Dec. 31	To Balance brought down	√	4,500	0	0						

13 PLANT AND MACHINERY. 14

Dr.			£	s.	d			J.	£	s.	d. Cr.
19... Dec. 31	To Balance	√	8,000	0	0	19... Dec. 31	By Realisation Account	24	800	0	0
						,, 31	,, Balance carried down	√	7,200	0	0
			£8,000	0	0				£8,000	0	0
19... Dec. 31	To Balance brought down	√	7,200	0	0						

15 LOOSE PLANT AND TOOLS. 16

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Balance	√	1,500	0	0						

17 STOCK. 18

Dr.			£	s.	d			J.	£	s.	d. Cr.
19... Dec. 31	To Balance	√	10,000	0	0	19... Dec. 31	By Realisation Account	24	1,000	0	0
						,, 31	,, Balance carried down ..	√	9,000	0	0
		£	10,000	0	0			£	10,000	0	0
19... Dec 31	To Balance brought down	√	9,000	0	0						

LEDGER—*continued.*

19 **SUNDRY DEBTORS.** 20

Dr.			£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Balance	√	14,000	0	0	19... Dec 31	By Realisation Account— Bad Debts Reserve	24	1,158	0	0
							Discounts and Costs (5 % on £14,000 – £1,158)		642	0	0
						„ 31	„ Balance carried down	√	12,200	0	0
		£	14,000	0	0			£	14,000	0	0
19... Dec. 31	To Balance brought down	√	12,200	0	0						

21 **A. LOAN ACCOUNT.** 22

Dr.			£	s.	d.		Cr.		£	s.	d.
						19... Dec. 31	By Balance	√	6,000	0	0

23 **CASH BOOK.** 24

Dr.			£	s.	d.		Cr.		£	s.	d.
19... Dec. 31	To Balance	√	2,500	0	0						

NOTE.—It is assumed that B and C paid direct for their share in the business.

25 **SUNDRY CREDITORS.** 26

Dr.		J.	£	s.	d.		Cr.		£	s.	d.
19... Dec. 31	To Reserve for Discounts, etc. ..	24	200	0	0	19... Dec. 31	By Balance	√	4,500	0	0
„ 31	„ Balance carried down	√	4 300	0	0						
			£4,500	0	0				£4,500	0	0
						19... Dec. 31	By Balance brought down	√	4,300	0	0

B & C.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.		£	s.	d.
Capital :—					Goodwill	5,000	0	0
B	£19,400				Land and Buildings	4,500	0	0
C	12,200				Plant and Machinery	7,200	0	0
		31,600	0	0	Loose Plant and Tools	1,500	0	0
Loan Account (A)		6,000	0	0	Stock	9,000	0	0
Sundry Creditors		4,300	0	0	Sundry Debtors	12,200	0	0
					Cash in hand and at Bank	2,500	0	0
	£	41,900	0	0	£	41,900	0	0

The student should realise that, in connection with all dissolutions, an account which has been adopted by partners for one purpose, e.g. the determination of profits during the continuance of the partnership as a going concern, is not necessarily compellable upon them for another purpose, e.g. the fixing of the valuation of the assets upon the death or retirement of a partner. Thus, in *Cruikshank* v. *Sutherland*, [1923] 128 L.T. 449, the articles provided that accounts were to be made up to the 30th April in each year, and each partner was to be bound thereby, save for manifest errors; they also provided that the amount of the share of a deceased partner was to be made up to the 30th April next after his decease. The assets included certain shares and debentures which had increased in value as against the book or cost figure. It was *held* that, in the absence of any uniform usage to the contrary [i.e. as to valuations on *death or retirement* of a partner], the assets of the firm should be taken at their fair value to the firm at the date of the account, and not at their book values.

Loss on Realisation. One Partner's Capital Account in Debit.—Previous illustrations have been based upon the assumption that the Capital Accounts of all partners were in credit. Should a debit balance be shown, the partner concerned must pay in a sufficient sum to discharge his liability, otherwise it will not be possible to pay the remaining partners the sums standing to their credit when the realisation is completed.

Illustration.—G. Emblem, C. Christine, and A. Ward are in partnership, and share profits one-half to Emblem and one-quarter each to Christine and Ward. They dissolve partnership and realise the assets. At the date of the dissolution the Balance Sheet of the firm was as follows:—

Emblem, Christine & Ward.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s	d.
Capital:—					Sundry Assets	7,320	0	0
G. Emblem	£6,500				Stock	2,470	0	0
C. Christine	3,200				Cash at Bank	1,260	0	0
A. Ward	500							
		10,200	0	0				
Creditors		850	0	0				
	£	11,050	0	0	£	11,050	0	0

The expenses of the realisation amounted to £375, Sundry Assets realised £4,840, and Stock realised £2,520.

LEDGER.

1 REALISATION ACCOUNT. 2

Dr.											Cr.
			£	s.	d.				£	s.	d.
19... Dec. 31	To Loss on Sale of Sundry Assets	√	2,480	0	0	19... Dec. 31	By Profit on Sale of Stock	√	50	0	0
„ 31	„ Expenses of Realisation ..	C.B. 4	374	0	0	„ 31	„ Balance carried down	√	2,804	0	0
		£	2,854	0	0			£	2,854	0	0
19... Dec. 31	To Balance brought down	√	2,804	0	0	19... Dec. 31	By G. Emblem, Share of Loss	5	1,402	0	0
						„ 31	„ C. Christine, Share of Loss	7	701	0	0
						„ 31	„ A. Ward, Share of Loss	9	701	0	0
		£	2,804	0	0			£	2,804	0	0

3 CASH BOOK. 4

Dr.											Cr.
			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance .. .	√	1,260	0	0	19... Dec. 31	By Sundry Creditors	√	850	0	0
„ 31	„ Cash, Proceeds Sale of Sundry Assets .. .	√	4,840	0	0	„ 31	„ Expenses of Realisation	1	374	0	0
„ 31	„ Cash, Proceeds Sale of Stock ..	√	2,520	0	0	„ 31	„ G. Emblem ..	5	5,098	0	0
„ 31	„ A. Ward (Cash paid in)	10	201	0	0	„ 31	„ C. Christine ..	7	2,499	0	0
		£	8,821	0	0			£	8,821	0	0

5 G. EMBLEM. CAPITAL ACCOUNT. 6

Dr.											Cr.
			£	s.	d.				£	s.	d.
19... Dec. 31	To Realisation Account	2	1,402	0	0	19... Dec. 31	By Balance	√	6,500	0	0
„ 31	„ Balance carried down	√	5,098	0	0						
		£	6,500	0	0			£	6,500	0	0
19... Dec. 31	To Cash	C.B. 4	5,098	0	0	19... Dec. 31	By Balance brought down	√	5,098	0	0

7 C. CHRISTINE. CAPITAL ACCOUNT. 8

Dr.											Cr.
			£	s.	d.				£	s.	d.
19... Dec. 31	To Realisation Account	2	701	0	0	19... Dec. 31	By Balance	√	3,200	0	0
„ 31	„ Balance carried down	√	2,499	0	0						
		£	3,200	0	0			£	3,200	0	0
19... Dec. 31	To Cash	C.B. 4	2,499	0	0	19... Dec. 31	By Balance brought down	√	2,499	0	0

LEDGER—*continued.*

9 A. WARD. CAPITAL ACCOUNT. 10

DR.			£	s.	d.				£	s.	d.
19... Dec. 31	To Realisation Account	2	701	0	0	19... Dec. 31	By Balance	√	500	0	0
						,, 31	,, Balance carried down	√	201	0	0
			£701	0	0				£701	0	0
19... Dec. 31	To Balance brought down	√	201	0	0	19... Dec. 31	By Cash	C.B. 3	201	0	0

CR.

The Sundry Creditors, Sundry Assets, and remaining Ledger accounts have been illustrated in several of the preceding problems, and need not occupy space again. It is possible, of course, that the results of the realisation may prove so unfortunate that the Capital Accounts of all the partners are in debit. This would mean that the available cash was insufficient to meet the claims of the outside creditors. When the amounts standing to the debit of the partners have been paid in, exactly enough cash will be available to meet the outside liabilities.

Loss on Realisation. One or More Partners Insolvent.—Prior to the case of *Garner* v. *Murray*, it had been the practice to include losses accruing from the default of a partner to make good his share of trading losses amongst those "losses, including loans and deficiencies of capital" referred to in S. 44 of the *Partnership Act*, 1890. Guided by that section of the Act, the accountant added the deficiency arising from a partner's default to the trading deficiency of the firm, and divided the total deficiency between the solvent partners in the proportion in which they shared the profits of the firm. It is submitted that from an accountant's point of view this treatment is the logically correct treatment. But the rule laid down by Mr. Justice Joyce in the case of *Garner* v. *Murray*, [1904] 1 Ch. 57 introduced a different principle, a principle that has given rise to acute controversy amongst accountants, and indeed to the expression of divergent views as to the manner in which the principle is to be applied. In the author's opinion, it would be unprofitable to traverse this argumentative field *de novo*, but inasmuch as the learned judge's decision appears to have assumed considerable importance in examination work, it may be advisable to deal with the case itself in some detail.

Garner, Murray, and Wilkins were in partnership in the year 1900 under a parol agreement. The capital of the firm was contributed in unequal proportions, but profits and losses were to be shared equally (one-third). The partnership was dissolved by order of the Court as from June 30, 1900. On completion of the dissolution the financial position was approximately as follows. Wilkins was insolvent and unable to contribute anything.

Garner, Murray & Wilkins.

STATEMENT OF AFFAIRS, JUNE 30, 1900.

		£	s.	d.		£	s.	d.
Capital :—					Wilkins (Debit Balance of Capital Account)	263	0	0
Garner	£2,500				Loss on Realisation	635	0	0
Murray	314	2,814	0	0	Cash	1,916	0	0
	£	2,814	0	0	£	2,814	0	0

Left to his own judgment, and guided by S. 44 of the Act of 1890, the accountant would have treated Wilkins's deficiency, £263, as a loss on realisation, added it to the firm's deficiency, £635, and then divided the aggregate loss, £898, between the solvent partners, one-half to each, since they shared profits and losses equally. By this treatment, Murray would have paid Garner £135, and Garner would have taken the whole of the cash balance, £1,916.

The Court, however, decided that Wilkins's deficiency must be distinguished from the losses of the firm as a whole, and that " the assets must be applied in paying to each partner rateably what was due from the firm to him in respect of capital, account being taken of the equal contributions to be made by him towards the deficiency of capital." This decision and the method of its application have quite naturally given rise to much controversy. A reasonable interpretation of the decision is that, after fulfilling all the firm's outside obligations, losses sustained by some of the partners owing to the default of another partner must not be treated as partnership losses to be borne in the ratio in which profits and losses are shared, but as a loss to be borne by the individual solvent partners rateably according to the amount of capital standing to their credit in the books of the firm, after taking into account the contributions made by them towards the deficiency of capital.

The effect of the decision in the case of Garner, Murray, and Wilkins was to make the firm's deficiency, £635, divisible equally amongst the three partners, whereas Wilkins's deficiency, £263, was to be borne by the two solvent partners in proportion to the credit balances of their capital accounts.

Procedure following Garner v. *Murray*.—So long as the ruling in *Garner* v. *Murray* stands, the procedure is as follows :—

Prepare a Realisation Account in the ordinary way. Divide the deficiency between the partners in the proportions in which profits or losses were shared. Open a Capital Account for each partner, crediting him with his capital and debiting him with his share of the firm's deficiency as shown by the Realisation Account. Rule off the insolvent partner's Capital Account, and bring down the (debit) balance, which represents the deficiency of the insolvent partner. Such deficiency constitutes for the solvent partners a further loss which must then be apportioned between them in proportion to their

respective Capital Accounts. The Capital Account balances to be used as the basis for dividing up the insolvent partner's deficiency among the solvent partners are: (*a*) the original capitals of the solvent partners—if these have remained unaltered at a fixed sum down to the dissolution; or (*b*) if the original capitals have been varied from time to time by agreement or periodical accounting between the partners, then the capitals as they stood after the last such variation before the dissolution.

It is submitted that the balances on Current Accounts are ignored in fixing the ratio in which the loss has to be borne by the remaining partners.

Illustration.—A, B, and C are equal partners. Dissolution takes place. C is bankrupt. A Realisation Account is prepared, and the deficiency is debited in equal shares to the three partners, whose capital accounts, original and final, stood as follows:—

	Original Capital.			Capital Account Balance after debiting share of loss on Dissolution Realisation.		
			£			£
A	Credit Balance	.. ..	4,000	Credit Balance	.. ..	3,000
B	Credit Balance	.. ..	2,000	Credit Balance	.. ..	1,000
C	Credit Balance	.. ..	600	Debit Balance	.. ..	400

The deficiency shown by C's account (£400) must be divided as to £266 13s. 4d. (two-thirds) to A, and as to £133 6s. 8d. (one-third) to B. The balance of cash in hand will then exactly suffice to pay out to the two solvent partners, and, when posted, will close the books.

Illustration.—V. Verdier, M. Neil, and W. A. Richardson were in partnership, and shared profits as to one-half to Verdier, one-third to Neil, and one-sixth to Richardson. They decided to dissolve partnership as on December 31, 19... During the realisation of the assets Richardson was adjudicated a bankrupt. His estate proved insufficient to meet the preferential debts, no contribution from him towards his share of the firm's deficiency was therefore possible.

The Balance Sheet of the firm as on December 31, 19.., was as under. The capital accounts of the partners were originally: V. Verdier, £10,000; M. Neil, £8,000; and W. A. Richardson, £1,000; but by subsequent yearly adjustments made by agreement between the partners at the annual accounting periods, the capital account balances had been reduced to those shown in the Balance Sheet subjoined:—

DR. BALANCE SHEET, DECEMBER 31, 19... CR.

	£	s.	d.		£	s.	d.
Capital—				Leasehold Factory	3,000	0	0
V. Verdier	6,000	0	0	Plant and Machinery	2,800	0	0
M. Neil	3,000	0	0	Patents	1,000	0	0
Sundry Creditors	5,214	0	0	Fixtures and Fittings	320	0	0
				Stock	2,680	0	0
				Sundry Debtors	3,214	0	0
				Cash	1,000	0	0
				W. A. Richardson, Capital Account overdrawn	200	0	0
	£14,214	0	0		£14,214	0	0

The assets, other than Cash, realised the following amounts: Leasehold, £2,460; Plant and Machinery, £2,000; Patents, nil; Fixtures, £100; Stock, £2,000; Book Debts, £2,720. A contingent liability, amounting to £200, not provided for in the above balance sheet, materialised during the realisation. The expenses of realisation amounted to £62. Close the books of the firm in accordance with the ruling in *Garner* v. *Murray*.

LEDGER.

Realisation Account.

Dr. | Cr.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Loss on Realisation of Assets	3,734	0	0	By Deficiency— V. Verdier (one-half) ..	1,998	0	0
,, Contingent liability matured	200	0	0	M. Neil (one-third) ..	1,332	0	0
,, Expenses	62	0	0	W. A. Richardson (one-sixth)	666	0	0
	£3,996	0	0		£3,996	0	0

CASH BOOK.

Dr. | Cr.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Balance	1,000	0	0	By Sundry Creditors ..	5,214	0	0
,, Sundry Assets— Amount realised ..	9,280	0	0	,, Realisation Account: Expenses .. .. £62; Contingent liability 200	262	0	0
				,, Balance carried down	4,804	0	0
£	10,280	0	0	£	10,280	0	0
To Balance brought down	4,804	0	0	By V. Verdier	3,424	13	4
				,, M. Neil	1,379	6	8
	£4,804	0	0		£4,804	0	0

V. Verdier, Capital Account.

Dr. | Cr.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Realisation Account (share of loss)	1,998	0	0	By Balance	6,000	0	0
,, Balance carried down	4,002	0	0				
	£6,000	0	0		£6,000	0	0
To Share of Loss on W. A. Richardson's Account ($\frac{6000}{9000}$ths)	577	6	8	By Balance brought down	4,002	0	0
,, Cash	3,424	13	4				
	£4,002	0	0		£4,002	0	0

LEDGER—*continued.*

M. Neil, Capital Account.

Dr.	£	s.	d.		£	s.	d. Cr.
To Realisation Account (share of loss)	1,332	0	0	By Balance	3,000	0	0
,, Balance carried down	1,668	0	0				
	£3,000	0	0		£3,000	0	0
To Share of Loss on W. A. Richardson's Account ($\frac{3000}{9000}$ths)	288	13	4	By Balance brought down	1,668	0	0
,, Cash	1,379	6	8				
	£1,668	0	0		£1,668	0	0

W. A. Richardson, Capital Account.

Dr.	£	s.	d.		£	s.	d. Cr.
To Balance	200	0	0	By Balance carried down	866	0	0
,, Realisation Account (share of loss)	666	0	0				
	£866	0	0		£866	0	0
To Balance brought down	866	0	0	By V. Verdier ($\frac{6000}{9000}$ths) ..	577	6	8
				,, M. Neil ($\frac{3000}{9000}$ths) ..	288	13	4
	£866	0	0		£866	0	0

Periodical Payments during a Prolonged Dissolution.— Occasionally the winding up of a partnership takes some considerable time, in order that the several assets may be realised to the utmost advantage, although the partners naturally desire cash distributions on account of their shares from time to time, as and when funds become available. In such cases, if there is any doubt as to the continued solvency of any partner, it is advisable to adopt a cautious policy and to regulate the payments to each partner so that there is little or no risk of his having to refund any money received by him when the final position is determined. Consequently, periodical distributions should not be proportionate either to the partner's capitals *or* to their shares of profit or loss, but should be made on the assumption that no further realisations will take place beyond the sums already received.

Illustration.—F, G, and H have capitals of £800, £500, and £700, and share profits and losses as to one-half, one-third, and one-sixth respectively. After paying the creditors, the following sums become available, it being agreed that they shall be distributed as and when determined :—

		£
Jan. 1.	Net Proceeds of Sale of Machinery	100
Mar. 1.	Cash Realised on account of Book Debts	400

Further assets remain to be realised. You are required to show the sums to be paid to the partners out of the amounts stated.

Solution.

		F.	G.	H.
		£	£	£
Jan. 1.	Balances of Capitals, Cr.	800	500	700
	Payment made			100
	Balances being then	800	500	600
Mar. 1.	Payments made	50		350
	Balances being now as 3 : 2 : 1 ..	750	500	250

NOTE.—If no further sums are available, the balances on the capital accounts are now proportionate to the partners' *risk of loss*, on a basis of £1,500, i.e. total capitals of £2,000, less net realisations £500. When additional amounts become available, say £300 on June 1st, they can safely be distributed as to F one-half, £150; G one-third, £100; and H one-sixth, £50, i.e. in the common ratio of capitals *and* risk of loss. Should a partner be insolvent and so unable to contribute his share of the loss that would arise should no further realisations be made, then, in adopting the most cautious method of repayment, allowance might be made for the possibility of having to deal with the partner's resulting debit balance under the rule in *Garner* v. *Murray*.

Where all partners are substantial men, there is not the same need for caution, and, indeed, the partners would probably refuse to consider such a method of division. A reasonable method would then be to divide each sum available in the capital ratio, but adjusting for profits or losses to date in the profit-sharing ratio.

Elliott *v.* Elliott, [1911] 45 Accountant Law Reports, 47.— This case should be noticed briefly, as it contains several points of interest to accountants. From the decision in this case, it would appear that the amount due to a deceased partner is not a liability of the firm but of *each individual partner*.

Stephen Elliott and his sons Alfred, Charles, and George, were in partnership sharing profits in the proportion four-elevenths, three-elevenths, two-elevenths, and two-elevenths respectively. The partnership articles provided that upon a death occurring, the surviving partners should assume the liabilities of the firm and take over the deceased partner's share in the assets and goodwill in proportion to their respective shares in the business, and that for this purpose the goodwill was to be valued at £10,000. The surviving partners were to execute a joint and several bond securing the payment of the amount due to the deceased partner in eight half-yearly instalments. Alfred died in 1906, and the amount of his share, valued on the above basis, was treated in the books and Balance Sheet as a liability of the firm to his executors, and payments on account were made from time to time in reduction of the debt. Subsequently, the surviving partners, under a new agreement, fixed the value of the goodwill at £800, the former figure being held to be fictitious.

Elliott, senior, died in September 1910, and his representatives contended that his share should be valued on the basis that the value of the goodwill was £10,000. It was decided that the subsequent

agreement, which fixed the value at £800, held good. When an account was taken at the death of Alfred, the stock was valued at selling prices less 30 % to arrive at the net value, and that practice was followed until the death of Elliott, senior, when an independent valuer was called in, who valued the stock at a much lower figure than a valuation at selling price less 30 % would have shown. The executors of Elliott, senior, contended that the firm was bound by the valuation method adopted in 1906, and sought to set aside the independent valuation. They also questioned whether the debt due to Alfred's executors, half of which remained unpaid, was properly treated as a partnership debt in the Balance Sheet of the firm submitted to them. It was held that the previous stocktakings were for an entirely different purpose than determining the value of a deceased partner's interest in the business, and that the independent valuation was right and proper. It was also held that the audited Balance Sheets were binding upon all the partners, including Elliott, senior, notwithstanding that he was illiterate and unable to understand them.

The amount due to Alfred's executors had been treated in the partnership books as a liability of the firm, and payments on account had been made out of the firm's funds which had reduced the debt to one-half of its original amount. Seeing that Alfred's executors had accepted the firm's cheques in reduction of the debt, it may naturally be assumed that they considered the firm liable. It was decided, however, that while these payments must stand, the balance still due was a personal liability of the partners individually, not a partnership liability, and that it must not appear in the firm's Balance Sheet. The learned judge said, "I think it is a debt due by each partner to the son's executors as the purchase money for *a personal benefit acquired by that partner*. The balance remaining due must be struck out of the Balance Sheet."

Elliott, senior, had from time to time overdrawn his share of the profits, and had made no refunds to the firm, although the articles provided that overdrawings should be repaid. The amounts had therefore been debited to his capital account. It was contended that this practice had relieved Elliott of his liability to refund, but it was decided that the procedure did not relieve Elliott from liability to refund overdrawings, the amount of which must therefore be treated as an asset of the firm.

The most important of the decisions mentioned above is the one ruling that the surviving partners of a firm are personally liable to the representatives of a deceased partner for his share in the business when ascertained. In the Elliott case, when Alfred's share had been determined on the agreed basis, the amount should have been transferred to the credit of the surviving partners in the ratio in which they shared profits, and those partners would then have become each personally liable to Alfred's estate for a private debt. The payments

LEDGER—*continued.*

3 A. CHATENAY. CAPITAL ACCOUNT. 4

DR. CR.

			£	s.	d.				£	s.	d.
						19..					
						Jan. 1	By Balance	√	10,000	0	0
						,, 1	,, Share of Goodwill	J. 15	1,500	0	0
						,, 1	,, H Dickson, Capital Account..	√	9,000	0	0
								£	20,500	0	0

5 J. CLARKE. CAPITAL ACCOUNT. 6

DR. CR

			£	s.	d				£	s	d.
						19...					
						Jan. 1	By Balance	√	8,000	0	0
						,, 1	,, Share of Goodwill	J. 15	1,500	0	0
						,, 1	,, H. Dickson, Capital Account..	√	9,000	0	0
								£	18,500	0	0

GOODWILL ACCOUNT. 8

DR. CR.

			£	s.	d				£	s.	d.
19...											
Jan. 1	To Sundries ..	J. 15	6,000	0	0						

Chatenay and Clarke now become personally liable to Dickson for the amounts transferred to their respective Capital Accounts. If the remaining partners preferred not to create a goodwill account for so large an amount as £6,000, they could have confined the account to the £3,000 to which Dickson was entitled, in which case a Goodwill Account for £3,000 would have been opened, a like amount being credited to Dickson's Capital Account.

Limited Partnerships.—Under *Bovill's Act*, 1865, and subsequently under SS. 2 and 3 of the *Partnership Act*, 1890, it became possible to advance loans to a partnership business in return for a share of profits from the business without incurring the liabilities incident to partnership proper. Such loans could be made, however, only to individuals and not to firms. The principle of limited liability in partnership was first introduced into partnership law by the *Limited Partnership Act*, 1907. By this Act, loans can be made to a firm in return for a share of profits, and Rules applicable to limited partnership, known as *Limited Partnership Rules*, have been issued under the authority of S. 17 of the Act. The advantages afforded by the registration of private limited companies so greatly outweigh those of limited partnerships that very little advantage has been taken of the Act of 1907. But the student should, nevertheless, acquaint himself with the provisions of the Act.

Registration.—A statement, signed by all parties, must be filed with the Registrar of Joint Stock Companies, giving (*a*) the firm name, (*b*) general nature of the business, (*c*) the full name of each partner, (*d*) the term of the partnership and the date when it began, (*e*) a statement that the partnership is limited, (*f*) the sum contributed by each limited partner, and how paid, whether in cash or otherwise. Notification of any change in the above particulars must also be filed within seven days. The registration fees are: On registration, £2; stamp duty, £1 per £100 (S. 39, *Finance Act*, 1920), or fraction thereof on the amount of capital contributed by the limited partner (or partners). The duty of registering under the Act lies with the general partners, but the limited partner (or partners) will be wise in his (or their) interests to make sure that registration has been duly made.

"General" and "Limited" Partners.—A limited partnership may consist of one or more general partners whose liability is unlimited, and one or more limited partners whose liability is limited to the capital they have agreed to contribute to the business. There must be at least one partner of either class; and not more than twenty persons, or ten in the case of a bank, may enter into a limited partnership. A body corporate, e.g. a limited company, may become a limited partner.

Examination experience suggests that it is necessary to point out to some students that, although a shareholder under the *Companies Act*, 1929, and a limited partner under the *Limited Partnership Act*, 1907, can strictly limit their personal liability to the amount they agree to subscribe, the *trading liabilities* of the company, or the partnership, cannot be limited. All the resources, in both cases, are liable to meet trade debts and obligations.

Rights of Limited Partners.—A limited partner cannot take part in the management of the business, but, personally or by his agent, he may inspect the books, inquire into the prospects of the business, and offer advice thereon (S. 6, ss. 1). If he withdraws any of the capital he has contributed to the business, he becomes liable for the debts and obligations of the firm to the extent of the sums withdrawn, as well as to the extent of the balance of his undrawn capital. He may assign his share in the business with the consent of his co-partners (S. 6, ss. 5), and the assignee is subrogated to the rights and obligations of the assignor, becoming a limited partner in the place of the assignor. If a limited partner "interferes" in the management of the business he may become liable as a general partner for the debts and obligations of the firm. If a general partner becomes a limited partner, or a limited partner assigns his share in the business, notification must be advertised in the *Gazette*.

A limited partner who has given a bank guarantee will not be deemed to have made a payment to the firm in cash, for the guarantee

is merely the assumption of a future contingent liability, and he may be held liable as a general partner (*Rayner & Co.* v. *Rhodes*, [1926] 24 Lloyd's List Reports, 25).

Dissolution.—A limited partnership is not dissolved by the death, lunacy, or bankruptcy of a limited partner, as an ordinary partnership is, neither can a limited partnership be dissolved by notice given by the limited partner. Upon a dissolution, the affairs of the firm are wound up by the general partners in accordance with the law and rules of Bankruptcy, or of the Deeds of Arrangement Act, as the case may demand.

Accounts.—Generally speaking, the accounts of a limited partner do not differ from those of an ordinary partner engaged in similar business, although the provisions of the Act of 1907 may affect the position of the partners as between themselves. The Capital Account of a limited partner will be credited with the amount he contributes, and the heading of the account should make it clear that he is a limited partner. The balance of the limited partner's Capital Account should make it clear that the capital is *fixed*, subject of course to any increase in the capital by further contributions. A Current Account, kept upon the lines already explained, should record all the other dealings of a limited partner with the firm.

The outstanding difference in limited partnership book-keeping lies in the treatment of losses. Should losses occur, the limited partner's share will be debited to his Current Account. The partner concerned would not be entitled to withdraw any further sums from the firm until such losses have been recompensed out of subsequent profits. This would seem to be clear from S. 7 of the Act of 1907, which provides that the *Partnership Act* of 1890 applies also to limited partnerships, except as expressly modified, or excluded by the Act of 1907. A limited partner can, of course, claim repayment of advances made by him irrespective of his Current Account, but he cannot withdraw profits until the debit balance of his Current Account has been made good.

But the limited partner is liable only to the extent of the capital he contributes. Therefore, should dissolution occur, the losses charged to his Current Account could not be recovered. If moneys are periodically withdrawn in anticipation of profits which do not materialise, such withdrawals amount to a technical breach of S. 4 (3) of the Act of 1907. In effect they are withdrawals of capital, and should therefore be made good as soon as possible.

Illustration.—Dickson, Chatenay, and Uprichard are in partnership. Dickson and Chatenay are general partners. Uprichard is a limited partner who has contributed £5,000 as capital and is entitled to one-fifth of the profits. Dickson and Chatenay each contributed £4,000 to the capital of the firm, and are entitled to share equally in the balance of the profits.

Dickson, Chatenay & Uprichard.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED JUNE 30, 19...

(FINAL SECTION.)

19...		£	s.	d.	19...		£	s.	d.
June 30	To Dickson, $\frac{2}{5}$ profits ..	1,774	0	0	June 30	By Balance brought down, being net profit for the year	4,435	0	0
" 30	" Chatenay, $\frac{2}{5}$ profits ..	1,774	0	0					
" 30	" Uprichard, $\frac{1}{5}$ profits ..	887	0	0					
	£	4,435	0	0		£	4,435	0	0

BALANCE SHEET, JUNE 30, 19...

		£	s.	d.		£	s.	d.
Capital :—					Sundry Assets	16,705	0	0
Dickson	£4,000				Cash at Bank	1,315	0	0
Chatenay	4,000							
Uprichard	5,000							
		13,000	0	0				
Current Accounts :—								
Dickson	..£985							
Chatenay	.. 765							
Uprichard	.. 270							
		2,020	0	0				
Sundry Creditors		3,000	0	0				
	£	18,020	0	0	£	18,020	0	0

After three years of bad trade the annual accounts were as follows :—

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED JUNE 30, 19...

(FINAL SECTION.)

19...		£	s.	d.	19...		£	s.	d.
June 30	To Balance brought down, being net loss for the year	6,935	0	0	June 30	By Dickson, $\frac{2}{5}$ loss ..	2,774	0	0
					" 30	" Chatenay, $\frac{2}{5}$ loss ..	2,774	0	0
					" 30	" Uprichard, $\frac{1}{5}$ loss ..	1,387	0	0
		£6,935	0	0			£6,935	0	0

BALANCE SHEET, JUNE 30, 19...

		£	s.	d.			£	s.	d.
Capital :—					Sundry Assets		17,801	0	0
Dickson	£4,000				Cash at Bank		236	0	0
Chatenay	4,000				Current Accounts :—				
Uprichard	5,000				Dickson	£2,603			
		13,000	0	0	Chatenay	3,108			
Sundry Creditors		13,598	0	0	Uprichard	2,850			
							8,561	0	0
	£	26,598	0	0		£	26,598	0	0

Unless the firm recovers prosperity, the position is as follows : Dickson and Chatenay, whose liability is unlimited, will be responsible to the full extent of their resources for the whole of the outside liabilities of the firm. Uprichard cannot be called upon for further contributions, except to make good any sums withdrawn by him and included in the Current Account debit

balance of £2,850. He may lose the whole of his £5,000 capital, but that is the end of his liability. Neither can he be called upon to make good the adverse balance of his current account.

Should prosperity return to the firm, it is possible that future profits may accrue to Uprichard that will suffice to extinguish the debit balance of his Current Account and restore his capital to its original amount. In the event of future profits being made, Uprichard cannot withdraw them until he has made good the adverse balance of his Current Account, and so restored his capital to the agreed amount.

Loans.—As in the case of ordinary partners, a limited partner may advance money on loan on agreed terms, quite apart from the capital he has introduced. Such loans are repayable notwithstanding that the partner's Current Account may be overdrawn. There is no right of set-off as between Loan Accounts and Capital and Current Accounts, because a limited partner is under no obligation beyond the amount of his agreed contribution of capital.

Sleeping or Dormant Partners.—Examination candidates frequently confuse a sleeping or dormant partner with a limited partner. The two are quite distinct. A sleeping partner is a partner who takes no active share in the business. He contributes capital in return for a share of the profits, and is as fully liable for the debts and obligations of the firm as is an active partner, for the law recognises no distinction between the two. A limited partner's liability is, as we have seen, restricted to his agreed capital contribution.

Winding Up.—Limited partnerships are now wound up, under the *Bankruptcy Act*, 1914, in the same manner as are ordinary partnerships.

EXAMINATION QUESTION.

C. Fitzgerald and A. Colomb are in partnership, sharing profits as to two-thirds and one-third respectively. On January 1st they took their manager, M. Farmer, into partnership. Farmer was to be credited with £500 at the close of each year, as a partnership salary, and with 5 % on the net profits prior to division.

On December 31st the following Trial Balance was extracted from the books of the firm :—

	£	£
C. Fitzgerald, Capital Account		10,000
C. Fitzgerald, Current Account	1,484	
A. Colomb, Capital Account		8,000
A. Colomb, Current Account	863	
M. Farmer, Current Account	321	
Factory and Warehouse	7,868	
Machinery and Plant	9,640	
6 % Loan Account (J. Smith)		5,000
Carried forward	£20,176	23,000

	£	£
Trial Balance (*continued*)	20,176	23,000
Manufacturing Wages	18,767	
Loose Tools	1,576	
Office Salaries and Expenses	3,872	
War Loan Interest		38
Bad Debts	182	
Rates, Taxes, and Insurance (Factory, £922; Office, £240)	1,162	
Travellers' Salaries and Commission	2,326	
5 % War Loan	967	
Purchases and Sales	21,642	57,150
Returns (Inwards and Outwards)	324	424
Discount Account (Balance)		189
Audit Fee	55	
Carriage (Inwards, £398; Outwards, £632) ..	1,030	
Bad Debts Reserve (January 1st)		400
Cash in hand	78	
Cash at Bank	236	
Stock (January 1st)	5,249	
Sundry Debtors and Creditors	9,760	9,235
Manufacturing Expenses	2,684	
Factory Power and Light	978	
Apprentices' Premiums		300
Bills Payable		1,265
Machinery Repairs	617	
Factory Space and Power Sublet		350
Interest Account	150	
Office Furniture	520	
	£92,351	£92,351

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended December 31st, and a Balance Sheet as on that date.

When preparing these accounts, the following particulars must be taken into consideration: (*a*) Provide for depreciation as follows: Machinery and Plant, 15 %; Office Furniture, 7½ %. (*b*) The following expenses were owing as on December 31st: Wages, £123; Office Salaries, £68; Machinery Repairs, £163. (*c*) Interest at 5 % is allowed on Capital. Interest on drawings is to be charged as follows: Fitzgerald, £41; Colomb, £28; Farmer, £8. (*d*) Provide for the six months' interest at 6 % due to J. Smith on his Loan as on December 31st. (*e*) Carry forward £32, Factory Insurance, to next year. (*f*) On December 31st Stock was valued at £8,787, and Loose Tools at £1,200. (*g*) Reserve 5 % on the Sundry Debtors for Bad and Doubtful Debts. (*Royal Society Arts—Intermediate Stage.*)

[NOTE—For solution, *see* pp. 224–226.]

Solution

Fitzgerald, Colomb & Farmer.

MANUFACTURING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

DR.									CR.					
				£	s.	d.						£	s.	d.
To Stock (January 1st)				5,249	0	0	By Sales	£57,150	0	0				
„ Purchases	£21,642	0	0				*Less* Returns	324	0	0				
Less Returns	424	0	0									56,826	0	0
				21,218	0	0	„ Apprentices' Fees*					300	0	0
„ Manufacturing Wages				18,890	0	0	„ Space and Power Sublet					350	0	0
„ Carriage Inwards				398	0	0	„ Stock (December 31st)					8,787	0	0
„ Manufacturing Expenses				2,684	0	0								
„ Power and Light				978	0	0								
„ Machinery Repairs				780	0	0								
„ Rates, Taxes, and Insurance				890	0	0								
„ Balance, being Gross Profit, carried to Profit and Loss Account				15,176	0	0								
			£	66,263	0	0					£	66,263	0	0

* Where apprentices' fees appear in an examination question, candidates should carefully seek for any indication that they cover a *period in advance* of that covered by the accounts under preparation. If they include any amounts paid for future years, the sums so paid in advance must be carried forward as a liability, and deducted from the amount credited in the Manufacturing Account.

Fitzgerald, Colomb & Farmer.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.		£	s.	d.	Cr.	£	s.	d.
To Office Salaries and Expenses		3,940	0	0	By Balance brought from Manufacturing Account	15,176	0	0
,, Travellers' Salaries and Commission		2,326	0	0	,, War Loan Interest	38	0	0
,, Carriage Outwards		632	0	0	,, Discount Account	189	0	0
,, Rates, Taxes, and Insurance		240	0	0				
,, Audit Fee		55	0	0				
,, Bad Debts, Reserve (December 31st)	£488 0 0							
,, Bad Debts written off	182 0 0							
	670 0 0							
Less Reserve (January 1st)	400 0 0							
		270	0	0				
,, Interest on Loan		300	0	0				
,, Depreciation *:—								
Machinery and Plant (15 %)	£1,446 0 0							
Office Furniture (7½ %)	39 0 0							
Loose Tools	376 0 0							
		1,861	0	0				
,, Balance carried down		5,779	0	0				
		£15,403	0	0		£15,403	0	0
To Salary (Farmer)		500	0	0	By Balance brought down	5,779	0	0
Interest on Capital:—					,, Interest on Drawings	77	0	0
Fitzgerald	£500 0 0							
Colomb	400 0 0							
		900	0	0				
,, M. Farmer (5 %)	£222 16 0							
,, C. Fitzgerald (two-thirds balance)	2,822 2 8							
,, A. Colomb (one-third balance)	1,411 1 4							
		4,456	0	0				
		£5,856	0	0		£5,856	0	0

* Practice varies as to the treatment of Depreciation on Machinery and Loose Tools. In some cases these charges are, perhaps more logically, debited to the Manufacturing Account.

Fitzgerald, Colomb & Farmer.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.	£	s.	d.
Capital :—						
C. Fitzgerald	10,000	0	0			
A. Colomb	8,000	0	0			
				18,000	0	0
Current Accounts :—						
C. Fitzgerald :						
Balance	1,484	0	0			
Interest on Drawings	41	0	0			
	1,525	0	0			
Share of Profits £2,822 2 8						
Interest on Capital 500 0 0						
	3,322	2	8			
				1,797	2	8
A. Colomb :						
Balance	863	0	0			
Interest on Drawings	28	0	0			
	891	0	0			
Share of Profits £1,411 1 4						
Interest on Capital 400 0 0						
	1,811	1	4			
				920	1	4
M. Farmer :						
Balance	321	0	0			
Interest on Drawings	8	0	0			
	329	0	0			
Share of Profits £222 16 0						
Salary 500 0 0						
	722	16	0			
				393	16	0
Loan (J. Smith)..	5,000	0	0			
Interest accrued	150	0	0			
				5,150	0	0
Sundry Creditors	9,235	0	0			
Do. (Wages £123, Salaries £68, Repairs £163)..	354	0	0			
Bills Payable	1,265	0	0			
				10,854	0	0
			£	37,115	0	0

	£	s.	d.	£	s.	d.
Factory and Warehouse				7,868	0	0
Machinery and Plant	9,640	0	0			
Less Depreciation	1,446	0	0			
				8,194	0	0
Office Furniture	520	0	0			
Less Depreciation	39	0	0			
				481	0	0
Loose Tools	1,576	0	0			
Less Depreciation	376	0	0			
				1,200	0	0
Stock				8,787	0	0
Sundry Debtors	9,760	0	0			
Less Reserve	488	0	0			
				9,272	0	0
5 % War Loan				967	0	0
Cash at Bank	236	0	0			
Cash in hand	78	0	0			
				314	0	0
Amounts paid in advance carried forward				32	0	0
			£	37,115	0	0

EXAMINATION QUESTION.

J. B. Clark, a cigarette manufacturer, agreed to take his manager, L. Hillingdon, into partnership on January 1st.

The following terms were agreed: (*a*) A goodwill account amounting to £10,000 was to be created, and a similar amount credited to J. B. Clark. (*b*) L. Hillingdon was to be entitled to a salary of £400 per annum, to be paid monthly. (*c*) Twelve monthly drawings on account of profits were to be made by the partners, i.e. J. B. Clark, £60 per month; L. Hillingdon, £20 per month. (*d*) Profits and losses were to be shared as follows: J. B. Clark, two-thirds; L. Hillingdon, one-third. (*e*) L. Hillingdon was to pay in £2,000 as his capital in the business on January 1st.

You are to assume that, as on December 31st following, all the entries and payments arising out of the terms of the above agreement had been carried out. In addition to the accounts necessary for the record of the above transactions, the following balances were extracted from the books of the firm as on December 31st:—

J. B. Clark, Capital Account (January 1st), £20,000; Plant and Machinery, £17,800; Fixtures and Fittings, £2,400; Rent and Rates of Factory, £950; Lighting (Factory £120, Office £24), £144; Licence and Insurance (Factory £300, Office £72), £372; Rent and Rates of Office, £270; Factory Expenses £571; Factory Power, £494; Office Expenses, £124; Sales: Cigarettes, £151,862; Shorts and Sundries, £2,234; Sales Returns: Cigarettes, £321; Shorts and Sundries, £124; Purchases: Tobacco, £76,294; Sundries, £2,421; Purchases Returns: Tobacco, £1,821; Sundries, £106; Office Salaries, £1,694; Factory Wages, £8,751; Packing Expenses (Charge to Trading Account), £1,792; Carriage (Inwards £821, Outwards £940), £1,761; Travellers' Salaries and Expenses, £2,371; Advertising, £5,000; Stock (January 1st), £16,841; Sundry Creditors, £4,682; Sundry Debtors, £22,540; Leasehold Factory, £10,000; Cash at Bank, £7,240; Cash in hand, £1,070.

You are required to prepare Trading and Profit and Loss Accounts for the year ended December 31st, and a Balance Sheet as on that date.

Before preparing the accounts, the following adjustments are necessary: (1) The following depreciation is to be written off: Machinery and Plant, 10 %; Fixtures and Fittings, 15 %. (2) A reserve for Bad Debts is to be made equal to 5 % on the Sundry Debtors. (3) A sum equal to 5 % of the net profits is to be reserved for distribution as a bonus to the firm's employees. (4) The Stock on hand, as on December 31st, was valued at £17,560. (5) 50 % of the cost of advertising is to be carried forward. (6) Interest at 5 % is to be credited to the partners' Capital Accounts, but no interest is to be charged upon drawings. (7) The following amounts were owing at the end of the year: Factory Wages, £68; Office Salaries, £35 (*London Chamber Commerce—Advanced Stage.*)

[NOTE—For solution, *see* pp. 228–230.]

Solution.

Clark & Hillingdon.

TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr

		£	s.	d.	£	s.	d.
To Stock (January 1st)					16,841	0	0
,, Purchases—							
Tobacco	£76,294						
Less Returns	1,821	74,473	0	0			
Sundries ..	£2,421						
Less Returns	106	2,315	0	0	76,788	0	0
,, Factory Wages					8,819	0	0
,, Packing Expenses					1,792	0	0
,, Carriage Inwards					821	0	0
,, Rent and Rates					950	0	0
,, Lighting					120	0	0
,, Factory Power					494	0	0
,, Factory Expenses					571	0	0
,, Licence and Insurances ..					300	0	0
,, Balance, being Gross Profit for the year, carried to Profit and Loss Account					63,715	0	0
				£	171,211	0	0

Cr.

		£	s.	d.	£	s.	d.
By Sales—							
Cigarettes	£151,862						
Less Returns	321	151,541	0	0			
Shorts and Sundries ..	£2,234						
Less Returns	124	2,110	0	0	153,651	0	0
,, Stock (December 31st) ..					17,560	c	0
				£	171,211	0	0

Clark & Hillingdon.

DR. PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19... CR.

		£	s.	d.		£	s.	d.
To Salaries		1,729	0	0	By Balance brought from Trading Account	63,715	0	0
,, Travellers' Salaries and Expenses		2,371	0	0				
,, Office Lighting		24	0	0				
,, Rent and Rates		270	0	0				
,, Insurance		72	0	0				
,, Office Expenses		124	0	0				
,, Carriage Outwards		940	0	0				
,, Advertising		2,500	0	0				
,, Depreciation—								
Plant (10 %)	£1,780 0 0							
Fixtures (15 %)	360 0 0							
		2,140	0	0				
,, Reserve for Bad Debts		1,127	0	0				
,, Bonus to Staff (5 % on £52,418)		2,620	18	0				
,, Balance carried down, being Net Profit for the year		49,797	2	0				
	£	63,715	0	0	£	63,715	0	0
To Interest on Capital (5 %)—					By Balance brought down	49,797	2	0
J. B. Clark	£1,500 0 0							
L. Hillingdon	100 0 0							
		1,600	0	0				
,, Salary (L. Hillingdon)		400	0	0				
,, J. B. Clark (two-thirds)	£31,864 14 8							
,, L. Hillingdon (one-third)	15,932 7 4							
		47,797	2	0				
	£	49,797	2	0	£	49,797	2	0

NOTE.—Partners' Salaries and Interest are appropriations of profit and, unless otherwise agreed, should not be charged before calculating the bonus to employees.

Clark & Hillingdon.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.			£	s.	d.
Capital :—					Goodwill		10,000	0	0
J. B. Clark—					Leasehold Factory		10,000	0	0
As at December 31, 19..	£20,000 0 0				Plant and Machinery	£17,800 0 0			
Add Goodwill ..	10,000 0 0				*Less* Depreciation (10 %)	1,780 0 0			
		30,000	0	0			16,020	0	0
L. Hillingdon—					Fixtures and Fittings	£2,400 0 0			
As at December 31, 19..		2,000	0	0	*Less* Depreciation (15 %)	360 0 0			
Current Accounts :—							2,040	0	0
J. B Clark—					Stock		17,560	0	0
Interest on Capital	£1,500 0 0				Sundry Debtors ..	£22,540 0 0			
Share of Profits ..	31,864 14 8				*Less* Reserve for Bad Debts at 5 % ..	1,127 0 0			
	33,364 14 8						21,413	0	0
Less Drawings ..	720 0 0				Advertising carried forward		2,500	0	0
		32,644	14	8	Cash at Bank	£7,240 0 0			
L. Hillingdon—					Cash in hand	1,070 0 0			
Interest on Capital	£100 0 0						8,310	0	0
Share of Profits ..	15,932 7 4								
	16,032 7 4								
Less Drawings ..	240 0 0								
		15,792	7	4					
Sundry Creditors	£4,682 0 0								
Ditto. Wages owing ..	68 0 0								
Ditto. Salaries owing ..	35 0 0								
Ditto. Bonus to Staff ..	2,620 18 0								
		7,405	18	0					
	£	87,843	0	0		£	87,843	0	0

EXAMINATION QUESTIONS.

1. What is a partnership ?

State the advantages to be derived by keeping separate Capital and Current Accounts for the partners in a firm. (*Incorporated Secretaries.*)

2. Heriott Brothers consists of three partners (A, B, and C). The capital is held as follows : A, £10,000 ; B, £12,000 ; and C, £7,500. Interest at 5 % is allowed upon capital and is charged on drawings, upon which there are no restrictions as to amount or date. C is entitled to be credited with a salary of £400 per annum. B lent £5,000 to the firm at 6 % interest. All the partners withdrew goods from the firm for personal use.

In what form should the partners' accounts be recorded in the books of the firm ?

Illustrate your answer by submitting a specimen of each kind of account you recommend the firm to employ. (*Royal Society Arts.*)

3. C and D were in partnership, C, who had money, providing £10,000 capital, and D, who had more experience, providing only £500. In addition C had lent the firm £1,000 half-way through the year. There was no agreement between them beyond a verbal one that profits should be shared equally. The first year's trading resulted in a profit of £2,505. C contended that interest at the rate of 5 % should be charged upon capitals and upon the loan before dividing the profit.

Was he correct ? If not, show how the profit should be dealt with and your reasons for dividing in the way you do. (*Chartered Accountants.*)

4. A and B are in partnership sharing profits in the proportion of two-thirds and one-third respectively. C, who is manager to the firm, and is in receipt of a salary of £1,000 a year, is taken into partnership and is given a quarter of the profits, A and B still sharing in the proportions of two and one. It is agreed between A and B that the latter shall not suffer in the amount he receives in the new partnership by reason of the fact that C now takes a share of profits instead of a salary. The profits of the firm are constant and may be assumed at £4,000 per annum after charging the manager's salary.

You are required to show the division of the profit under the new arrangement and to give the proportions in which profits should be divided for inclusion in the new partnership agreement. (*Chartered Accountants.*)

5. Scarlett and Lake join in partnership on January 1st, without any formal deed between them. The capital introduced was as follows : Scarlett, £3,000 ; Lake, £2,000. On April 1st Lake advanced £500 to the firm as a loan without any agreement as to interest. The net profit for the half-year to June 30th is £2,500. The partners cannot agree on the following points : Interest on capital, interest on loan, division of profits. Prepare accounts on the lines that you would adopt, giving reasons for your action. (*Central Association Accountants.*)

6. George and Hugh Dickson agree to admit George McArthur as a partner in their firm as on January 1st.

The terms agreed upon were as follows : (*a*) McArthur was to pay £6,000 cash into the business, of which sum £1,800 was to be treated as a premium and divided as to two-thirds to George Dickson and one-third to Hugh Dickson. (*b*) In addition, McArthur was to bring in stock £3,000 and book debts £2,500. (*c*) Profits were to be divided : George Dickson, four-sevenths ; Hugh Dickson, two-sevenths ; and George McArthur, one-seventh.

The Balance Sheet of the old firm, as on the previous December 31st was as follows :—

BALANCE SHEET, DECEMBER 31ST.

	£		£
Capital—		Freehold Property	8,000
George Dickson	18,000	Machinery and Plant ..	19,500
Hugh Dickson	10,000	Sundry Debtors	8,740
Sundry Creditors	11,174	Stock	1,948
		Cash at Bank	986
	£39,174		£39,174

Prepare the Balance Sheet of the new firm as on January 1st. (*Royal Society Arts.*)

7. A and B are partners, but no details have been agreed between them, verbally or by deed, other than the fact that profits are to be shared equally.

At the close of the year, B prepared the following Profit and Loss Account :—

PROFIT AND LOSS ACCOUNT.

		£		£
To 5 % Interest on Capital—			By Balance from Trading Account	1,885
A	£250			
B	150			
		400		
,, Salary, B		200		
,, Interest at 5 % on Loan from A		75		
,, Balance carried down ..		1,210		
		£1,885		£1,885
To A, ½ Share		605	By Balance brought down ..	1,210
,, B, ½ Share		605		
		£1,210		£1,210

If you do not approve of this account, amend it. (*Royal Society Arts.*

8. Submit a *pro-forma* Current Account showing (*a*) Drawings and interest thereon ; (*b*) Interest on Capital ; (*c*) Partnership Salary ; and (*d*) Share of Profits. (*Royal Society Arts.*)

9. A, B, and C are in partnership, sharing profits equally, and at 31st March their Capital Accounts were as follows : A, £8,000 ; B, £7,000 ; C, £6,000.

On 1st April they admitted D as an equal partner, he having agreed to bring in £5,000 as his capital and to pay the old partners £2,100 for goodwill. Each of the old partners was to leave one-half his share of the latter sum in the business, and to withdraw the other half.

Show the four partners' Capital Accounts as they will appear after the change, all payments having been made as agreed. (*London Chamber Commerce.*)

10. Explain, by means of specimen accounts, the best method of recording the accounts of partners in the books of the firm of which they are members.

In your answer deal with capital, drawings, loans, interest, and withdrawals of goods. (*London Chamber Commerce.*)

11. A, B, and C are in partnership upon the following terms : (1) Interest on capital is allowed at 5 %. (2) Partners' monthly drawings are allowed as

follows: A, £50; B, £40; C, £30. No interest is chargeable on these drawings. (3) Partners' salaries are: B, £300 per annum; C, £200 per annum: these sums are to be credited to the respective current accounts at the close of each year. (4) Profits are to be shared as follows: A, four-sevenths; B, two-sevenths; C, one-seventh. (5) The fixed capital is as follows: A, £10,000; B, £6,000; C, £2,000. (6) It is agreed that half C's salary is to be debited to A.

Prior to any of the adjustments arising out of the above terms, the profits for the year ended December 31st last were £5,825.

Prepare the final section of the Profit and Loss Account, and the Partners' Accounts as on December 31st last. (*Royal Society Arts.*)

12. Hugh and George Dickson agree to admit William Robinson, their manager, into partnership as on January 1st. Interest at 5 % is allowed on capital, which is as follows: Hugh Dickson, £10,000; George Dickson, £5,000; William Robinson, £1,000.

Robinson is to be credited with a salary of £300 per annum, £200 of which is to be debited to Hugh Dickson and £100 to George Dickson. After providing for interest on capital, the profits are to be divided as follows: Hugh Dickson, four-ninths; George Dickson, three-ninths; William Robinson, two-ninths. No interest is charged on drawings, which were as follows: Hugh Dickson, £1,500; George Dickson, £800; William Robinson, £400.

The profit for the year ended December 31st amounted to £4,250 before making any of the above adjustments.

Give the partners' accounts as they would appear in the Balance Sheet as on December 31st. (*Royal Society Arts.*)

13. McArthur and Chatenay are in partnership, and share profits and losses as to two-thirds to McArthur and one-third to Chatenay. The capital is held as follows: McArthur, £12,000; Chatenay, £6,000. On December 31st the credit balances of the partners' current accounts were: McArthur, £1,800; Chatenay, £960.

On January 1st following, the firm admitted Pirrie into partnership on the following terms: Goodwill to be valued at £6,000 and to be credited to the capital accounts of the original partners. The current accounts to be transferred to the capital accounts. Pirrie to bring in, as capital, an amount equal to one-fourth of the total capital of the original partners as adjusted above.

Give the capital accounts as they would appear in the initial Balance Sheet of the new firm on January 1st. (*Royal Society Arts.*)

14. Richard Black and William White enter into partnership, upon equal terms, for the purpose of purchasing and continuing the old-established business of the late Robert Blank. The business was taken over from Blank's executors as on January 1st, as a going concern, upon the basis of the last certified Balance Sheet, which was as follows:—

R. Blank.

BALANCE SHEET, DECEMBER 31ST.

LIABILITIES.	£	ASSETS.	£
To Capital	26,593	By Freehold Premises ..	14,200
,, Sundry Creditors ..	3,482	,, Plant Account	8,100
,, Reserve for Bad Debts	385	,, Sundry Debtors	3,420
		,, Stock on hand	4,140
		,, Office Furniture	600
	£30,460		£30,460

The purchase price was agreed at £28,000, which amount was found, in equal shares, by Black and White, and duly paid over to Blank's executors.

In addition each partner paid £1,000 into the new firm's banking account to provide working capital, and it was agreed, before opening the new books, to reduce the valuation of the Plant (as shown above) by £500, the Stock by £450, and the Office Furniture by £200.

Make the opening entries necessary to record the above transactions in the books of the new firm, and draw up a Balance Sheet showing the position of Messrs. Black and White at the commencement of the new partnership. (*Chartered Accountants.*)

15. Jeeves and Wooster are partners, sharing profits and losses as to Jeeves two-thirds and Wooster one-third, and they agree to admit Bertie as a partner on June 1st. Bertie is to bring in capital amounting to £3,000, and is also to pay £600 as premium, the latter to remain in the business. Show the entries you would make in the books of the firm. (*London Association Accountants.*)

16. At January 1st, X, Y, and Z had the following respective capitals, viz. £3,330, £4,225, and £3,762. They shared profits in the ratio 3, 5, and 6 At that date they sold their assets for £9,177. They owed their creditors £208, and Y had advanced £555 on loan to the firm.

Prepare Balance Sheet, Realisation Account, Cash Account, and Partners' Capital Accounts. (*London Association Accountants.*)

17. X, Y, and Z were partners in a manufacturing business, sharing profits as follows: X, four-sevenths; Y, two-sevenths; Z, one-seventh.

Under a clause in the partnership deed, any partner was at liberty to retire and claim an annuity of £150 for each one-seventh share held by him in the profits; his share in the assets and goodwill to pass to the remaining partners in equal shares. Y retired from the firm on January 1st, the amount standing to the credit of his capital account being £6,800.

How should you treat the annuity payable to Y, for the year ended on the preceding December 31st? (*Royal Society Arts.*)

18. Jones and Webb, who are partners, sharing profits and losses as to five-eighths and three-eighths, admit Williams into partnership as from July 1st. The Partnership Deed provides that Williams shall receive one-fifth of the net profits after allowing £400 salary and 4 % interest on capital for each partner.

On July 1st following, it was ascertained that £4,000 net profit had been made before charging partners' salaries or interest on capital. The capital accounts were as follows: Jones, £6,000; Webb, £4,000; and Williams, £1,500.

Prepare Appropriation Account and Partners' Capital Accounts. (*London Association Accountants.*)

19. A and B are in partnership, sharing profits equally. As from December 31st they admit C, and from that date share: A, four-tenths; B, four-tenths; C, two-tenths. It is agreed that the Balance Sheet of A and B as on December 31st requires amendment as follows: Insurance Fund, credit balance, £1,780, is to be reduced to £280; Plant and Machinery are undervalued by £500; Reserve for Bad Debts, £230, is to be increased to £400; J. Jones, debtor for goods supplied, £1,270, is to be written off as bad to the amount of £1,090, the difference of £180 being the surrender value of a life policy held as security, which is taken over by the new partnership.

Subject to these adjustments, C agrees to pay £2,000 for the acquisition of a two-tenths share in profits and goodwill.

Prepare Revaluation Account, adjusting the accounts as agreed, and show the treatment of the sum paid for Goodwill. (*Chartered Accountants.*)

20. A and B are equal partners. In order to provide funds to pay out the executors of a deceased partner, a joint policy of assurance for £5,000 is taken out with the Northern Assurance Company. The sum assured is payable at the death of either partner. The annual premium is £450.

Show, by means of specimen entries, how the above transaction should be recorded in the books of the firm at the end of the first year after the assurance was effected. (*Royal Society Arts.*)

21. A firm has taken out life assurance policies on the lives of the partners and the managers. How would you deal with the premiums in the accounts? Should they be shown as an accumulating asset in the Balance Sheet? Comment hereon. (*Incorporated Secretaries.*)

22. T. Landry and R. Lambert, who were equal partners in a manufacturing business, agreed to dissolve partnership and to realise their business as on June 30th. On that date their Balance Sheet was as follows :—

Messrs. T. Landry & R. Lambert.

BALANCE SHEET, JUNE 30TH.

LIABILITIES.	£	ASSETS.	£
T. Landry, Capital Account	3,000	Sundry Assets	5,150
R. Lambert, Capital Account	700	Cash	850
Sundry Creditors	2,300		
	£6,000		£6,000

The expenses of the realisation, which were paid in cash, amounted to £270, and the Sundry Assets realised £3,920 in cash.

You are required to show fully the result of the realisation, which was concluded on August 16th. Under the partnership articles, in the event of there being any deficiency on the capital account of either partner, the amount of such deficiency is to be at once made good in cash. (*London Chamber Commerce.*)

23. A. and B. Blank are partners. There is no partnership agreement. The partnership was dissolved as on December 31st, when the Balance Sheet was as follows :—

BALANCE SHEET, DECEMBER 31ST.

LIABILITIES.	£	ASSETS.	£
Capital—		Goodwill	2,500
A. Blank	10,000	Freehold Premises	10,000
B. Blank	5,000	Sundry Debtors	3,862
Sundry Creditors	3,714	Stock	2,480
Bank Overdraft	1,000	Cash in hand	10
		Cash at Bank	862
	£19,714		£19,714

The assets were realised as follows: Goodwill, £1,000; Freehold Premises, £12,500; Sundry Debtors, £2,972; Stock, £2,090. Allowances were obtained from creditors amounting to £270. The expenses of the dissolution amounted to £172.

Show the final result of the dissolution and the amounts payable to the partners. (*Chartered Institute Secretaries.*)

24. S, T, and U were partners sharing profits and losses equally. On the dissolution of the partnership on December 31st, the Balance Sheet was as follows :—

	£		£
Sundry Creditors	8,000	Cash	800
Capital Account—		Sundry Debtors	4,200
S	2,500	Stock	6,000
T	2,000	Furniture and Fittings ..	300
U	1,000	Goodwill	2,200
	£13,500		£13,500

On realisation, Stock was sold at a discount of 30 % on book values.

Sundry Debtors realised £3,500 ; Furniture and Fittings, £150 ; Goodwill, £450.

The expenses of realisation were £120.

Ascertain the deficiency and prepare accounts, showing the final position of each partner's capital after adjustment, consequent upon U being able to bring in only £250 towards his share of the deficiency. (*Incorporated Accountants.*)

25. George McArthur and Arthur Hadley were equal partners. McArthur died on December 30th. Accounts were prepared at the close of the financial year (December 31st), when it was found, after ascertaining and crediting the profit for the year in the ordinary way, that the partners' accounts stood as follows : McArthur, Capital Account, £8,000 ; Current Account (credit balance), £962. Hadley, Capital Account, £7,000 ; Current Account (credit balance), £852.

It was agreed with McArthur's Executors that the value of the goodwill, which had not hitherto appeared in the books, should be fixed at £3,000, and that the assets and liabilities should be reviewed. Valuations were made with the following results : The book value of the Plant and Machinery was reduced by £500 ; the Reserve for Bad Debts was found to be excessive by £200 ; the Stock was undervalued by £350 ; the Sundry Creditors were overstated by £670 ; and the Patents (book value £300) were held to be of no value.

Submit the partners' accounts as they would appear in the Revaluation Balance Sheet. (*Royal Society Arts.*)

26. On the dissolution of the partnership of N and O, the assets realised £17,500, subject to the cost of realisation, £250. The liabilities were : Overdraft at Bank, secured by a charge, £1,500 ; other Creditors, £6,500 ; Loan from N, £5,000 ; Capital, N, £5,000 ; Capital, O, £2,500 ; Loan from O, £1,000.

Profits and losses were to be shared in the proportion of two-thirds to N, one-third to O. State the order of priority in which the payments should be made, and show in account form how the cash realised would be distributed. (*Incorporated Accountants.*)

27. A, B, and C were in partnership and shared profits and losses in the proportions of one-half, one-third, and one-sixth respectively. They decided to dissolve partnership as on June 30th. C was adjudicated a bankrupt during the realisation of the assets and was unable to contribute anything to his deficiency in the firm.

The partners' capitals were originally A, £10,000 ; B, £5,000 ; and C, £2,500 ; but were reduced to the figures appearing in the following Balance

Sheet by adjustments made upon agreement between the partners at the end of the usual accounting periods.

BALANCE SHEET, JUNE 30TH.

	£		£
A, Capital Account	7,000	Freehold Premises	4,200
B, Capital Account	2,000	Plant and Machinery ..	2,400
Sundry Creditors	5,650	Fixtures and Fittings ..	800
		Stock	2,600
		Sundry Debtors	3,500
		Cash	700
		C, Capital Account overdrawn	450
	£14,650		£14,650

The assets realised the following amounts: Freehold Premises, £4,500; Plant and Machinery, £1,900; Fixtures and Fittings, £300; Stock, £1,400; Sundry Debtors, £3,000.

The expenses of realisation were £300.

You are required to close the books of the firm. (*Chartered Accountants.*)

28. A and B were equal partners in a business from which A retired on December 31st.

The Balance Sheet of the firm was then as follows :—

BALANCE SHEET, DECEMBER 31ST.

		£		£
Capital Accounts—			Plant and Fixtures	800
A	£5,100		Stock	3,600
B	2,600		Sundry Debtors	4,000
		7,700	Cash	1,500
Sundry Creditors		2,200		
		£9,900		£9,900

Under the Partnership Agreement, a partner retiring was entitled to be paid, for his share of the goodwill, two years' purchase of his share of the profits, based upon the average of the three years preceding his retirement. The profits of the firm for the last three years were £9,600.

Any bad debts incurred in the realisation of the debtors were to be taken as bad debts of the firm at the date of any retirement, but not so to affect the figures previously used for the calculation of the amount of goodwill. These amounted to £200.

It was agreed that A should be paid out, with interest at 5 % per annum, by half-yearly instalments of £1,000 (covering interest and principal) until discharged, the first payment being made on June 30th following. So far as the debtors and creditors were concerned, interest was only to be calculated from the date of receipt or payment.

You are required to show A's account at the close of the year, assuming that the creditors were paid and the debtors realised at an average date of six months. (*Chartered Accountants.*)

29. X and Y are in partnership. The profits are shared as to three-fourths to X and one-fourth to Y.

The Balance Sheet of the firm, as on September 30th, was as follows :—

	£		£
Capital : X	18,000	Freehold Premises	20,000
Y	6,000	Fixtures and Furniture ..	2,000
Creditors	4,600	Sundry Debtors	5,682
Loan from X	4,000	Stock	4,334
Reserve Account	1,400	Cash at Bank	1,984
	£34,000		£34,000

The partners decided to dissolve the firm and realise the assets.

X agreed to purchase the Freehold for £18,000, whilst Y took the Stock over at a discount of 15 %. The book debts realised 94 % of the Balance Sheet figure. The Fixtures and Furniture realised £1,742. The realisation expenses amounted to £784.

Give the accounts necessary to show the result of the realisation. (*Royal Society Arts.*)

30. In the firm of E and F, E is a general and F a limited partner. To the capital of the firm, which amounts to £25,000, F has contributed £5,000, and out of the profits is entitled to receive interest at the rate of 8 % per annum, and one-tenth of the remaining profits. E is entitled on account of his share of the profits to draw £100 a month. At the end of the first year the following figures are extracted from the books of the firm :—

Capital Account, F, £5,000 ; Capital Account, E, £20,000 ; Creditors, £10,500 ; Debtors, £8,000 ; Land and Buildings, £13,500 ; Plant and Machinery, £7,500 ; Stock and Stores, £10,500 ; Cash, £2,400 ; E, Drawings Account, £1,200 ; F, Drawings Account, Interest, £400 ; Profit and Loss Account, £8,000.

From these figures draft Trial Balance and prepare accounts showing the profits due to each partner and the position of their accounts before the balance of profits respectively due is paid out. (*Incorporated Accountants.*)

31. A, B, and C are in partnership, sharing profits in the proportions of one-half, one-third, and one-sixth respectively. The X Company, Ltd., whose £1 shares have a market value of 23s. each, agrees to purchase the undertaking of A, B, and C (*excluding* cash), the consideration to be the taking over of the liabilities and the allotment of 10,000 shares in the company. The Balance Sheet of A, B, and C as on the date of purchase was :—

	£		£
Creditors	2,863	Goodwill	2,000
A, Capital	5,000	Plant and Machinery ..	4,782
A, Undrawn Profits	224	Debtors	3,168
B, Capital	4,000	Stock	2,715
B, Undrawn Profits	182	Cash	691
C, Capital	1,000		
C, Undrawn Profits	87		
	£13,356		£13,356

The partners agree amongst themselves that the balance of cash remaining after payment of their undrawn profits shall be divided equally between them, but they cannot agree as to the correct division of the shares. Prepare statements showing how in your opinion the shares should be divided, having regard to their market value. Ignore fractions. (*Chartered Accountants.*)

32. Bell and Broughton were in partnership sharing profits and losses as to three-fifths and two-fifths respectively. They decide to sell their

business to the Lyte Engineering Company, Ltd., as at June 30th, at which date their Balance Sheet was as follows :—

Bell & Broughton.

BALANCE SHEET, JUNE 30TH.

LIABILITIES.		£	ASSETS.		£
Capital—			Cash in hand	£50	
Bell	£15,000		Cash at Bank	500	
Broughton ..	10,000				550
		25,000	Sundry Debtors		14,450
Bell, Loan Account		2,500	Stock-in-Trade		18,000
Sundry Creditors		7,500	Plant and Machinery ..		6,000
Reserve Account		5,000	Fixtures, Fittings and Trade Utensils		1,000
		£40,000			£40,000

The Company agreed to purchase the Book Debts, Stock, Plant and Machinery, Fixtures, etc., and Goodwill, the consideration being £15,000 in cash and the allotment of 15,000 shares of £1 each in the Lyte Engineering Company, Ltd., which were quoted on the market at date of sale at a premium of £1 per share. The liabilities were paid by the partners. It was agreed as regards the purchase consideration that Broughton should receive half the shares in the Lyte Engineering Company, Ltd.

Prepare accounts showing the final settlement between the partners. (*London Association Accountants.*)

33. D, E, and F are equal partners, whose Balance Sheet at June 30, 1921, was as follows :—

LIABILITIES.	£	ASSETS.	£
D, Capital	20,000	Plant and Machinery ..	12,000
E, Capital	10,000	Trade Debtors	7,000
Trade Creditors	5,000	Stock-in-Trade	6,000
		F, Capital Account	5,000
		Freehold Property	5,000
	£35,000		£35,000

They dissolve the partnership. The assets upon sale realise £19,000, and the expenses amount to £1,000.

Following the rule in Garner *v.* Murray, you are required to close the accounts. (*Incorporated Accountants.*)

34. X and Y are in partnership, sharing profits and losses four-sevenths and three-sevenths respectively. Their Balance Sheet on December 31st was as follows :—

	£		£
Creditors	2,000	Goodwill	1,000
Capital, X	6,000	Property	4,000
Capital, Y	3,000	Debtors	4,000
		Cash	2,000
	£11,000		£11,000

Z joins them on January 1st following, it being agreed that he shall receive one-fifth share of profits, the shares of X and Y bearing the same relation to each other as heretofore.

Z's Balance Sheet is as follows :—

	£		£
Creditors	1,500	Property	2,000
Capital	2,000	Debtors	1,000
		Cash	500
	£3,500		£3,500

Before opening the books of the new partnership it is agreed that the following adjustments shall be made:—X and Y: Value of property to be reduced by £1,000; A Reserve at 5 % on Debtors to be made; Goodwill to be increased or decreased to allow for these adjustments. Z: Value of property to be increased by £500; a Reserve at 5 % Debtors to be made; Creditors to be increased to £1,700; a Goodwill Account of £1,000 to be raised and the balance of Z's Capital Account to be increased or decreased to allow for these adjustments.

Show the opening Balance Sheet of the new partnership, indicating the proportions in which X, Y, and Z will share in the profits and losses. (*Institute of Book-keepers.*)

35. G. McArthur and C. Fitzgerald are in partnership upon the following terms :—(*a*) The fixed capital of the partners is: McArthur, £15,000; Fitzgerald, £8,000. (*b*) 5 % interest is allowed upon capital and charged upon drawings. (*c*) Profits are shared: McArthur, two-thirds; Fitzgerald, one-third. (*d*) The goodwill of the business stands in the books at £5,000, and McArthur is to be credited with 2½ % as interest on this amount and Profit and Loss Account debited. (*e*) The partners are entitled to draw each year on the last day of March, June, September, and December as follows: McArthur, £480; Fitzgerald, £240. (*f*) Fitzgerald is to be credited, at the close of each year, with £500 as salary. £100 of this amount is to be debited to McArthur's current account, and the balance to Profit and Loss Account. (*g*) During the year goods were supplied from stock as follows: McArthur, £196; Fitzgerald, £85; but no entries have yet been made in the books.

You are to assume that all the above conditions have been complied with and the necessary entries made in the books.

In addition to the accounts arising out of the above, the following balances were extracted from the books of the firm as on December 31st: Stock, £32,480; Freehold Warehouse, £5,640; Fixtures and Fittings, £960; Additions and Alterations (Warehouse), £1,000; Sales, £98,462; Purchases, £62,462; Returns (Sales), £324; Returns (Purchases), £941; Rates and Taxes (Warehouse, £1,141; Office, £136), £1,277; Lighting and Heating (Warehouse, £385; Office, £95), £480; Bank Overdraft, £2,067; Cash in hand, £108; Sundry Creditors, £9,796; Sundry Debtors, £7,860; Investment (5 % Debentures), £2,000; Bills Payable, £2,142; Bills Receivable, £1,241; Warehouse Expenses, £1,587; Warehouse Wages, £4,872; Provision for Bad Debts (January 1st), £250; Insurance (Warehouse, £486; Office, £38), £524; Interest Account (Credit Balance), £61; Carriage Outwards, £948; Carriage Inwards, £794; National Health Insurance (Warehouse), £84; Fixtures and Fittings sold during the year, £200; Office Furniture, £760; Vans and Horses, £1,572; Office Salaries, £2,104.

You are required to prepare Trading and Profit and Loss Accounts for the year ended December 31st, and a Balance Sheet as on that date.

When preparing these accounts the following matters must be taken into consideration: (1) The error in the Trial Balance (£38) must be carried to a "Difference in the Books Account." (2) The quarter's interest (5 %) on the investment to December 31st has accrued due, but has not been paid or passed through the books. (3) Write off the following depreciations: Fixtures

and Fittings, 15 %; Office Furniture, 5 %. (4) The following items were outstanding at the close of the year and no entries had been made in the books: Warehouse Wages accrued, £98; Office Salaries accrued, £46; Insurance (Warehouse) paid in advance, £121. (5) Provide 5 % for bad debts on the Sundry Debtors. (6) Write off one-half of the additions and alterations to warehouse. (7) The following valuations were made as on December 31st: Stock, £21,846; Vans and Horses, £1,400. (*Royal Society—Advanced.*)

36. Peter Pink and Benjamin Brown are in partnership, sharing profits and losses, two-thirds and one-third respectively. Interest on capital at 5 % is to be credited to the partners annually. The Trial Balance of their books at December 31, 19.., is as follows:—

	£	£
P. Pink—		
Capital Account		3,600
Current Account Balance, January 1, 19..		120
Drawing Account	1,004	
B. Brown—		
Capital Account		1,600
Current Account Balance, January 1, 19..		80
Drawing Account	847	
Office Furniture	840	
Sundry Debtors and Creditors	2,934	854
Purchases and Sales	37,060	43,021
Stock, January 1, 19..	1,880	
Carriage Inwards	292	
Returns Inwards and Outwards	125	220
Rent	375	
Salaries	630	
Carriage Outwards	56	
Discounts		331
Reserve for Bad Debts		500
Advertising	800	
Rates	180	
Insurance	62	
Insurance, National	27	
Telephone	26	
General Expenses	133	
Printing and Stationery	64	
Postage	117	
Repairs	21	
Electric Light	18	
Bank Charges	6	
Investment: £1,600 5 % Railway Stock at cost	1,557	
Interest on Investments		31
Cash at Bank	1,293	
Cash in hand	10	
	£50,357	£50,357

The Stock at December 31, 19.., is valued at £1,287.

Prepare Trading and Profit and Loss Accounts for the year ended December 31, 19.., and Balance Sheet at that date after making the following adjustments: one quarter's rent is outstanding; rates unexpired, £36; Insurance unexpired, £21; six months' interest accrued on Investment (less Income Tax at 4s. 6d.); carry forward one-half of the amount spent on Advertising; write off Bad Debts, £67; depreciate Office Furniture at 5 % per annum. (*Institute of Book-keepers.*)

37. The firm of Markham and Newbold (architects), to which you have been appointed secretary, has a capital of £5,000 provided as follows: G. Markham, £3,000; Alfred Newbold, £2,000, on which 5 % interest is to be credited to the partners' current accounts annually.

The figures, other than those representing capital and interest, contained in the Trial Balance of the books at December 31, 19.., are as follows: Rent, £600; Sundry Debtors, £1,800; G. Markham, Current Account, credit balance, £740; A. Newbold, Current Account, credit balance, £360; Apprenticeship Premiums, £1,200; Sundry Creditors, £270; G. Markham, Drawings, £1,100; A. Newbold, Drawings, £800; Salaries, £2,200; Professional Fees, £5,797; Furniture, £1,290; Investments, £2,500; Interest on Investments, £125; Telephone, £40; Cash at Bank, £2,350; Cash in hand, £20; Electric Light, £42; Printing and Stationery, £211; Drawing Materials, £270; Prints and Photos, £260; Miscellaneous Expenses, £9.

Prepare final accounts for the year ended December 31, 19... The following adjustments are necessary: Apprenticeship Premiums were for five years; four years to run from the commencement of the current year. Only three quarters' rent charged, one quarter due. Stock of Stationery in hand = £130. (*Incorporated Secretaries.*)

38. The firm of M and N consisted, on June 30th, of two partners, sharing profits in the proportions of four-sevenths and three-sevenths respectively. The Balance Sheet at that date showed :—

	£		£
Capital Account, M	8,000	Land and Buildings	3,500
Capital Account, N	6,000	Plant and Machinery	5,250
Creditors	7,500	Furniture and Fixtures ..	800
Profits not drawn	1,400	Stocks and Stores	5,700
		Debtors	6,600
		Cash	1,050
	£22,900		£22,900

It is agreed to admit O into partnership on July 1st, on payment of £2,100 for goodwill, divisible between M and N in the proportions in which they provided capital and divided profits. O also brings in £4,000 capital. One-half the profits not drawn on June 30th are to be divided between M and N in their respective proportions, the balance to remain in the business and to be credited in the same proportions to M and N's Capital Accounts. It is agreed that the Stock and Stores shall be reduced in value to £5,000, and that the reduction shall be charged to the Capital Accounts of M and N in the proportion of four-sevenths and three-sevenths. M, N, and O are to divide profits in proportion to their respective capital accounts as on July 1st. Show the respective Capital Accounts of the three partners as at that date, and state the proportions in which they will divide profits. Set out the Balance Sheet of the new firm as at July 1st. (*Incorporated Accountants.*)

39. O. Fitzgerald carried on business as a manufacturer of rubber heels and sundries. On January 1st he agreed to admit C. Testout as a junior partner on the following terms :—

A Goodwill Account of £3,000 was to be opened, and a similar amount credited to Fitzgerald's Capital Account. Fitzgerald was to draw £40 per month, and Testout £30 per month. No interest was to be charged on drawings, but 5 % interest was to be allowed on capital. Testout was to pay in £3,000 in cash as his capital. Testout was to be credited with a salary of £250. Profits were to be shared as to two-thirds to Fitzgerald and one-third to Testout.

On December 31st the undermentioned Trial Balance was extracted from the books of the firm :—

TRIAL BALANCE, DECEMBER 31ST.

	£	£
O. Fitzgerald—		
Capital Account		9,000
Drawings Account	480	
C. Testout—		
Capital Account		3,000
Drawings Account	110	
Goodwill	3,000	
Partnership Salary	250	
Plant and Machinery	2,840	
Loose Tools	520	
Sales		27,580
Sales Returns	108	
Purchases	9,684	
Purchases Returns		312
Machinery Repairs	349	
Stock (January 1st)	3,872	
Bad Debts	221	
Reserve for Bad Debts (January 1st)		400
Carriage Inwards	462	
Carriage Outwards	524	
Office Salaries	1,948	
Office Expenses	362	
Travellers' Salaries and Commission	1,486	
Factory Power	1,642	
Bills Receivable	325	
Factory Wages	4,894	
Rent and Rates (Factory)	1,278	
Rent and Rates (Office)	163	
Factory Expenses	821	
Insurance (Factory)	248	
Insurance (Office)	29	
Discount Account		84
Cash at Bank	464	
Bank Overdraft		4,000
Sundry Creditors		3,206
Sundry Debtors	9,862	
Office Furniture	240	
Motor Lorry	1,400	
	£47,582	£47,582

You are required to prepare a Factory Working Account and a Profit and Loss Account for the year ended December 31st, and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into consideration :—(*a*) The following depreciations are to be written off : Plant and Machinery, 10 % ; Office Furniture, 5 % ; Motor Lorry, 20 % ; Loose Tools, 15 %. (*b*) Sundry Loose Tools were made by the firm's workmen, and Wages £92 and Purchases £28 are to be transferred from these accounts to Loose Tools Account before calculating the above depreciation. (*c*) The Stock in hand, as on December 21st, was valued at £4,092. (*d*) The Reserve for bad debts is to be made up to £500. (*Royal Society Arts—Intermediate.*)

40. A, B, and C were in partnership in a manufacturing and trading concern under the style of A B & Co., sharing profits and losses in the proportions of 8, 6, and 1. Interest was to be at the rate of 6 % per annum on partners' capitals and at the rate of 5 % per annum on Current Accounts.

Drawings are made quarterly by equal instalments on September 30th, December 31st, March 31st, and June 30th. The following is a summary of the Current Accounts of the several partners for the year ended June 30, 1925 :—

	A	B	C
	£	£	£
Balance (Cr.), June 30, 1924	840	153	110
Profit and Interest for the year to June 30, 1924, credited as on September 30, 1924	2,070	1,545	252
	2,910	1,698	362
Less Drawings	2,500	2,000	300
	£410	Dr. £302	£62

The following Trial Balance was extracted from the books of the firm as on June 30, 1925 :—

TRIAL BALANCE, JUNE 30, 1925.

	£ s. d.	£ s. d.
Capital, June 30, 1924—		
A		25,000 0 0
B		20,000 0 0
C		4,000 0 0
B, Capital withdrawn March 31, 1925 ..	1,000 0 0	
Current Accounts June 30, 1925—		
A		410 0 0
B	302 0 0	
C		62 0 0
Machinery, June 30, 1924	7,095 10 0	
Machinery, Additions since	300 0 0	
Investments	2,015 0 0	
Bad Debt Reserve, June 30, 1924		250 0 0
Bad Debts	263 8 6	
Office Furniture	550 0 0	
Motor Lorry	390 0 0	
Rent, Factory	1,200 0 0	
Rent, Office	275 0 0	
Power, Factory	510 15 9	
Heating and Lighting, Factory	73 4 2	
Heating and Lighting, Office	39 5 9	
Expenses, Office and Factory	473 6 6	
Goodwill	5,000 0 0	
Interest on Investments		100 0 0
Stock, June 30, 1924	15,797 8 6	
Sundry Debtors and Creditors	4,411 1 10	3,571 0 0
Wages	14,105 14 0	
Machinery Repairs	509 10 0	
Discount	330 8 8	
Salaries and Commissions	1,809 5 0	
Purchases	39,106 17 3	
Sales		42,507 13 2
Cash at Bank	317 7 5	
Cash in hand	25 9 10	
	£95,900 13 2	£95,900 13 2

You are required to prepare Trading and Profit and Loss Accounts for the year ended June 30, 1925, and a Balance Sheet as on that date. In preparing these accounts adjustments are to be made in accordance with the following instructions: (*a*) The Stock valuation on June 30, 1925, was £34,486 19s. 2d. (*b*) The Bad Debt Reserve is to be made up to £300. (*c*) One-sixth of the Expenses is to be charged to the Office and the remainder to the Factory. (*d*) The following had accrued and were unpaid at June 30th: Wages, £224 13s.; Salaries, £134 5s. (*e*) Depreciation is to be charged as follows: Machinery, Old, 7½ %; New, 5 %; Furniture, 10 %; Motor Lorry, one-third. (*Chartered Accountants.*)

41. A firm of resin manufacturers, A B and C D, trading together as equal partners, agree that in the event of the death of one of the partners the survivor shall pay out the interest of the deceased partner and purchase his share, the purchase price to be the profits of the three preceding completed years.

A B died on October 1st. The Stock at that date was valued at £1,800, and the net profits for the three preceding completed years were as follows: £3,500, £2,100, and £1,823.

The following figures as at date of death were extracted from the books of the firm: A B, Capital Account, Amount at Credit, £2,000; C D, Capital Account, Amount at Credit, £2,000; A B, Drawing Account, in Debit, £300; C D, Drawing Account, in Debit, £200; Salaries, £575; Rent and Rates, £250; Stock (January 1st), £1,500; Wages, £1,200; Sales, £11,000; Purchases, £7,100; Returns, Outwards, £150; Sundry Debtors, £2,400; Trade Creditors, £2,100; Cash at Bank, £1,605; Petty Cash overdrawn, £10; Office Furniture and Fixtures, £100; Discounts Received, £220; Discounts Allowed, £250; Plant and Machinery, £1,750; General Expenses, £250.

You are required to prepare the necessary accounts to produce to the executors of A B showing what is due to his estate. The Partnership Deed provided that the assets should be taken at their book value. (*Incorporated Accountants.*)

Chapter VIII

CONSIGNMENT ACCOUNTS. JOINT VENTURE ACCOUNTS

I. Consignment Accounts.

A considerable part of the export and import trade of this country consists of goods sent on consignment to British agents by foreign manufacturers and exporters, or by British manufacturers and exporters to foreign agents. The book-keeping records of consignments are based upon ordinary double-entry methods, but special application of these methods is necessary, owing to the fact that the property in goods sent on consignment remains in the consignor or shipper until actual sale of the goods is effected.

Definitions.—In book-keeping terminology, goods sent by a principal to his agent for sale on behalf of the principal are termed a *consignment*. They are *Consignments Outwards* from the point of view of the principal, and *Consignments Inwards* from the point of view of the agent. Consignments usually involve some element of speculation. The principal in these transactions is termed the *consignor*; the agent is the *consignee*. Subject to any agreement between the parties, a consignee may pledge his principal's goods, give valid receipts upon sale of them either for cash or on credit, and exercise a lien upon them for any unpaid commission or expenses incurred by him in connection with the goods.

A consignee is remunerated for his services as agent by an agreed *commission* charged by him to his principal. This commission usually takes the form of a percentage on the gross proceeds of sale of the goods consigned. Where the consignee guarantees his principal against loss from bad debts, an additional commission, called a *Del Credere Commission*, is paid to him. In some cases, these two commissions are merged into one percentage.

The statement rendered by the consignee to the consignor, containing detailed particulars of the consignment, and detailed particulars of sales, expenses, and commission, and showing the net amount due to the consignor, is termed an *Account Sales* (A/S). A specimen Account Sales is shown on p. 249.

It is usual for the principal to forward to the agent a formal invoice for the goods termed a *Pro Formâ Invoice*. This is merely a memorandum for the guidance of the agent, giving a description of the goods—

weight, quantity, quality, shipping marks, etc.—and sometimes also stating a minimum or reserve selling price for the goods.

The all-important point to note in connection with consignment accounts is that, upon shipment of the goods, *no sale has taken place, and consequently no debtor exists. The consignee becomes a debtor only when he has sold the goods, either in whole or in part.* Indeed, the consignee may never become a debtor at all, since, being an agent, he may return the goods to the consignor, if he fails to sell them. Hence the need for the special book-keeping methods employed.

The records of outward consignments deal with the despatch of the goods, and the expenses connected therewith, such as packing, freight, insurance, etc. The accounts are closed by incorporating the information furnished by the Account Sales rendered by the consignee upon sale of the goods. Finally, therefore, the consignor's books record a complete history of the consignment, viz. details of the consignment, the expenses incurred thereon both by consignor and consignee, the commission charged by the consignee, and the net proceeds of sale. The records of inward consignments show details of the goods, the sales effected and their proceeds, the expenses incurred, the commission charged, the net proceeds of sale, and the remittance or remittances made to the consignor.

Where consignments are numerous, it is usual to keep a separate set of books for their service. These would consist of: A Consignment Ledger, a Cash Book, and an Account Sales Book. Consignment Accounts have a good deal in common with Branch Accounts.

It is a frequent practice for the consignor to draw a bill of exchange upon the consignee for a part of the value of the goods consigned, e.g. 75 per cent. of the value. The bill would be drawn at the time of shipment, and made payable at such a period after sight as will give the consignee time to dispose of the goods. The consignor may then attach the shipping documents to the bill and obtain an advance upon the bill from his banker (*see* Documentary Bill, p. 799).

Consignments Outwards.—Consignor's Books.—It has already been stated that goods sent on consignment remain the legal property of the consignor until sold. For this reason it is clear that he cannot debit their value to the personal account of the consignee. An account is, therefore, opened under the caption "Consignment to X"—the consignee's name being inserted. This account is debited with the cost of the goods consigned. A second account, called "Consignments Outwards Account," is credited with a like amount, and, at the close of a financial period, is finally closed by transfer to the consignor's Trading Account. In cases where the goods are invoiced to the consignee at a value above cost, it is essential that the profit thus anticipated shall not find its way to the Trading Account. As in the case of Branch Accounts, this is avoided either by (1) using two columns in the Consignments Outwards Journal (which contains details of all consign-

ments), for (*a*) cost price, and (*b*) invoice price, the cost price column only being posted, or, should this be impracticable, then (2) by eliminating the profit by debiting Consignments Outwards Account, and crediting Consignment to X Account with the excess of the invoice price over cost price. An Adjustment Account, similar to that used in the case of Branch Accounts, may be employed, but its use is cumbersome, and is not recommended.

Any expenses incurred by the consignor in despatching the goods, insuring them, etc., will be debited to the Consignment to X Account, Cash or the appropriate creditors' accounts being credited.

If a bill is drawn on the consignee at the time the goods are despatched, the personal account will be credited, and Bills Receivable Account debited. Any further entries will have to await receipt of the Account Sales from the Consignee. From the information contained in the Account Sales, the Consignment to X Account will be credited and the consignee debited with the gross proceeds realised by sale of the goods. The consignee will be credited and the Consignment to X Account will be debited with the expenses incurred and the commission charged by the consignee.

Should the consignee remit by draft, he will be credited and Bills Receivable Account be debited.

When all the goods have been sold, the Consignment to X Account is closed by transferring the balance (the net profit or net loss) to Profit and Loss Account. If the account is closed off before all the goods have been sold, the stock must first be inserted at cost price (or market price if lower, the local market price being taken) on the credit side, and brought down as a debit balance to the next financial period. When valuing stock, it is permissible to include any expenses incurred, such as freight, insurance, etc., in so far as they can be attributed to the portion unsold. As regards the consignor's expenses, these will usually relate to the whole consignment, including those goods already sold, and a simple apportionment will be necessary. But, in dealing with the consignee's expenses, all those relating solely to goods sold must be ignored when valuing stock, and that portion only relating to the goods unsold must be included.

Where practicable, quantity accounts will be kept to check the stock unsold at any date.

When preparing the Consignor's Balance Sheet, the important point to keep in view is that all unsold consignments must be treated strictly as *stock*, and so valued.

Consignments Inwards.—Consignee's Books.—The consignee makes no entry in his financial books on receipt of the goods, although he will no doubt need some descriptive memoranda of quantities received, etc. His one obligation is to account to the consignor for the proceeds of any sales effected, less expenses, disbursements, commission, etc. Thus the only additional account necessary is a

personal account for the consignor, which is credited with the proceeds of sales (cash, or debtors being debited) and debited with expenses and remittances (cash, creditors, or bills payable being credited). The consignee will calculate his commission (usually a percentage on gross sales) and will debit the consignor's account therewith, crediting his own Profit and Loss (or Commission Earned) Account.

From the following example, it will be seen that the effect of the system outlined above is to eliminate the cost of goods sent on consignment from the Trading Account and to credit Profit and Loss Account with the net proceeds of sale.

Illustration.—Jacobs & Co. of Manchester consigned 20 cases of goods to their agents, Denny & Co. of Durban, invoiced *pro formâ* as of a value of £1,250 (being cost plus 25 %). Jacobs & Co. paid freight, insurance, etc., £45, and drew on Denny & Co. at 90 d/s for £1,000. They discounted the bill at a charge of £22. An Account Sales was received in due course from the consignees, showing gross proceeds of sale, £1,525. The A/S was accompanied by a draft for the balance after the following items had been deducted: Commission, 6¼ % + 1 % *del credere*; landing and dock charges, storage, etc., £20. Show the records of these transactions as they would appear in the books both of consignors and consignees, and submit an Account Sales in the usual form.

ACCOUNT SALES 20 cases of goods received from Jacobs & Co., Manchester, per s.s. *Colestown*, sold by Denny & Co., Durban.

		£ s. d.	£ s. d.
	15 cases @ £70	1,050 0 0	
	5 cases @ £95	475 0 0	
			1,525 0 0
JACOBS & Co.	*Less*—		
D. & Co.	Landing and dock charges, storage, etc.	20 0 0	
	Commission, 6¼ % on £1,525	95 6 3	
217/236	*Del credere*, 1 % on £1,525 ..	15 5 0	
			130 11 3
			1,394 8 9
	Less Draft accepted against consignment ..		1,000 0 0
	Sight Draft herewith on Chartered Bank of South Africa		£394 8 9

E. & O.E.

DURBAN, *per pro.* DENNY & Co.

January 15, 19... JAMES ABERNETHY,

Accountant.

NOTE.—In actual practice, interest is frequently charged on disbursements from the date of their occurrence to the date of the Account Sales

JACOBS & CO.'S BOOKS.

CONSIGNMENT TO DENNY & CO., DURBAN.

Dr. Cr.

		£	s.	d.			£	s.	d.
19...	To Goods on Consignment Account ..	1,250	0	0	19...	By Consignee—Gross Proceeds	1,525	0	0
	,, Cash, Freight, Insurance, etc.	45	0	0		,, Goods on Consignment Account, adjustment of invoice price ..	250	0	0
	,, Consignee's Account: Landing Charges, etc.	20	0	0					
	Commission, 6¼ %..	95	6	3					
	Del Credere, 1 % ..	15	5	0					
		1,425	11	3					
	,, Profit and Loss Account	349	8	9					
	£	1,775	0	0		£	1,775	0	0

DENNY & CO., DURBAN

Dr. Cr.

		£	s.	d.			£	s.	d.
19...	To Consignment Account, Gross Proceeds	1,525	0	0	19...	By Bills Receivable ..	1,000	0	0
						,, Consignment Account Landing Charges, etc.	20	0	0
						Commission, 6¼ % ..	95	6	3
						Del Credere, 1 % ..	15	5	0
						,, Bills Receivable ..	394	8	9
	£	1,525	0	0		£	1,525	0	0

GOODS ON CONSIGNMENT OUTWARDS.

Dr. Cr.

		£	s.	d.			£	s.	d.
19...	To Consignment Account (to reduce to cost)	250	0	0	19...	By Consignment Account	1,250	0	0
	,, Trading Account ..	1,000	0	0					
	£	1,250	0	0		£	1,250	0	0

BILLS RECEIVABLE ACCOUNT.

Dr. Cr.

		£	s.	d			£	s.	d.
19...	To Denny & Co.	1,000	0	0	19...	By Cash	978	0	0
						,, Discount on Bills Account	22	0	0
	£	1,000	0	0		£	1,000	0	0
19...	To Denny & Co.	394	8	9					

DENNY & CO.'S BOOKS

JACOBS & CO., MANCHESTER, *re* CONSIGNMENT INWARDS *ex* S.S. *Colestown*.

DR.									CR.
19..		£	s.	d.	19...		£	s.	d.
	To Cash Landing Charges, etc. ..	20	0	0		By Sundries (Cash or Debtors), Proceeds of Sales	1,525	0	0
	,, Commission Account	95	6	3					
	,, *Del credere* Commission Account	15	5	0					
	,, Bills Payable	1,000	0	0					
	,, Bills Payable	394	8	9					
		£1,525	0	0			£1,525	0	0

EXAMINATION QUESTIONS.

1. On June 1, 1926, the Niger Coal Co., Ltd., consigned to Niger Sales, Ltd., in Illyria, 2,000 tons of coal invoiced at 20s. a ton. The pit cost of the coal and the rail freight (including wagon hire) to the port were 15s. and 4s. a ton respectively.

On June 25th an Account Sales was received from the Sales Company showing 1,000 tons sold at 32s. a ton; Ocean freight paid, 8s. a ton; Dock dues and demurrage, £88; Insurance, £12; Brokerage, $1\frac{1}{4}$ %; and Commission, $2\frac{1}{2}$ %. The consignees enclosed a bill for the proceeds, less expenses, and reported a shortage of weight of 40 tons on the whole consignment.

Show the necessary accounts in the books of the Niger Coal Co., Ltd. (*Chartered Accountants.*)

2. Alexanders & Co., wool brokers, sell "by order and on account and risk of" Pontifex & Rees, *ex Bendigo* at Australia, the following wool:—

Marks.	Lot.	Bales.	Gross Weight. c.	qr.	lb.	Tare and Draft. c.	qr.	lb.	
◇	89	25	89	2	4	3	2	0	at 2s. 2d. lb.
J.S.C.	90	28	101	3	2	3	2	15	at 1s. $11\frac{1}{2}$d. lb.

Set out the Account Sales in proper form. N.B.—The candidate is himself to specify the various charges likely to be deducted from the gross proceeds, and to allot purely nominal amounts for each item, showing finally the net proceeds. (*Royal Society Arts.*)

3. T. Russell, a colonial merchant with an office in London, is an agent for Messrs. Hall & Jones, of Christchurch, New Zealand, exporters of Canterbury lamb, etc. Included in the latter's 19.. season's shipments is a consignment of 7,000 carcases (2,500 lambs and 4,500 sheep) shipped per s.s. *Achilles*. Mr. Russell disposed of the whole of this consignment, obtaining orders as under at the prices stated:—

1,500 Lambs, weighing 50,000 lb. at 7s. per stone of 8 lb. c.i.f.
1,000 Lambs, weighing 34,000 lb. at 6s. 9d. per stone of 8 lb. c.i.f.
2,500 Sheep, weighing 140,000 lb. at 7d. per lb. *ex* store.
2,000 Sheep, weighing 110,000 lb. at 6d. per lb. delivered.

The charges paid in London in connection with this consignment were as under:—

	£	s.	d.
Marine Insurance	161	2	4
Fire Insurance	2	10	1
Storage Charges	78	1	9
Port Rates	3	10	0
Cartage	9	1	11
Claims	49	16	4

Messrs. Hall & Jones drew a bill on their London agent at thirty days' sight for £10,000, which was duly honoured at maturity. Prepare an Account Sales of the consignment referred to, providing for London agent's commission at the rate of 1 % on the gross proceeds.

Record all the transactions in the books of the consignee, opening the necessary accounts. (*Incorporated Accountants.*)

4. A acts as *del credere* agent for B. In A's books, which are made up to June 30, 19.., you find the following accounts :—

CONSIGNMENT INWARDS ACCOUNT.

	£		£
To B, 10,000 bales	5,000	By Sundry Debtors, 5,000 bales sold	2,700
,, Cash, Expenses of consignment	150	,, Balance	3,366
,, Commission, 8 % of £2,700	216		
,, Bad Debts incurred on Consignment Account	700		
	£6,066		£6,066

B.

		£		£
To Cash — 5,000 bales sold ..	£2,700		By Balance	246
Less Expenses and Commission ..	850		,, Consignment Account ..	5,000
Transmitted ..		1,850		
,, Balance		3,396		
		£5,246		£5,246

A asks how these accounts should be treated in his annual accounts, made up to June 30, 19... What answer would you give, and what suggestions would you make? (*Chartered Accountants.*)

5. On May 1, 19.., A, of London, ships on consignment to B, of Cape Town, for sale by the latter upon A's account, 50 cases of goods invoiced *pro formâ* at £10 a case. A commission of 3 % is payable to B upon sales, and all charges are borne by the consignor.

A pays freight and insurance in London amounting to £34, and draws upon B at three months' sight for £300 against the shipment.

B sells for cash 10 cases at £12 a case on July 1, 19.., 25 cases at £13 10s. a case on July 15th, and the balance on July 28th at £13 a case, having accepted A's draft on June 1, 19... He forwards an Account Sales to A on July 16th, deducting the commission due and charges incurred, such charges amounting to £27 for landing, storage, etc., and remits a draft for the balance.

You are required to prepare the Account Sales and to show how the transactions would appear in the consignor's books. (*Chartered Secretaries.*)

II. Joint Ventures.

Definition.—A joint adventure is a partnership limited to a particular trading operation or speculation. Such features of an ordinary partnership as firm-name, and continuity of business relationship, are absent from a joint venture. The legal relationship between joint venturers has not yet been clearly defined, but Lord Eldon once said that "a joint adventure is as proper a partnership as any other." Each adventurer contributes capital in agreed proportions, and shares the profit or loss from the adventure in agreed proportions. The close of the adventure terminates the partnership relationship.

Joint adventures usually relate to the purchase and sale of goods, but they may, of course, be entered into for speculative purposes, e.g. dealing in stocks and shares, or exchange operations, underwriting, etc.

Where Special Treatment is Necessary.—If a separate banking account is opened, and a separate set of books is kept for the venture, the book-keeping treatment is similar to that laid down for an ordinary partnership. If the venture is managed entirely by one of the adventurers at an agreed remuneration, as is often the case, the book-keeping is so simple as to need no demonstration. Only in cases where two or more of the joint adventurers conduct the business of the adventure independently, and no separate books are kept, is special book-keeping treatment required.

Where no separate set of books is kept, each adventurer opens a "Joint Venture with . . . Account," which he treats as a *personal account* of the joint adventure, debiting it with any payments made or liabilities incurred by him on account of the venture, and crediting it with any receipts—exactly as he would were he dealing with a private person. When the venture is completed, each adventurer sends to the other a copy of the Joint Venture Account as it appears in his books. The final account of the completed joint venture is then prepared by combining the individual Joint Venture Accounts : and the profit or loss revealed thereby is divided in the agreed ratio between the adventurers. Each adventurer then debits his Joint Venture Account with his share of the profit, or credits it with his share of the loss, crediting or debiting his own Profit and Loss Account with a like amount. The resulting balance remaining on each venturer's account indicates the amount due to or due from him.

If interim accounts of the joint venture are prepared, any stock or other assets must be valued and carried down as debit balances on the individual Joint Venture Account of the partner holding the assets, and also on the combined Joint Venture Account.

If interest is computed as between the joint venturers, the individual Joint Venture Accounts are treated in a similar manner to Accounts Current, interest on the items composing the accounts being debited or credited at the rate agreed.

In preparing the combined account of the joint venture, it is clear that the items will appear on the same debit or credit sides as in the individual accounts of the joint venturers, but that transactions between the venturers themselves will not appear, since these, of course, cancel each other.

Rules for Joint Venture Accounts.

(*a*) Each venturer must open in his books a Joint Venture Account, and must treat it as a personal account, debiting all payments, charges, interest, etc., and crediting all receipts and other credit items.

(*b*) When the venture is concluded, each venturer must send a copy of his personal account to each of his co-venturers.

(*c*) From the separate personal accounts, a combined Profit and Loss Account must be prepared showing the profit to be received, or the loss to be borne by each venturer.

(*d*) The venturers from whom balances are due must remit those balances in cash to those venturers to whom they are due, thus closing the respective accounts of all the venturers.

Illustration.—Black and White enter into a joint transaction in Government surplus stores. Black acquires a million yards of linen at 6d. per yard on January 1, 19.., and pays cash therefor (plus carriage). £25,040. It is agreed that he shall be allowed £100 per month for warehousing charges, office expenses, etc. White sends Black a bill for £10,000 dated January 1st, at 1 month (without days of grace). White pays advertising expenses, £500, on February 1st. Black discounts the bill on January 1st, discounting charges (to be borne by the venture) being £35. Settlement is to be made every 3 months, until completion of the venture. Interest, computed in months, is to be taken at 6 %. Profits or Losses are to be shared: Black, $\frac{3}{5}$ths; White, $\frac{2}{5}$ths.

Sales were as follows:—

3 months to March 31st: Black, 200,000 yards, £10,000.
White, 300,000 yards, £16,875.

Each party collected the cash for their own sales; the due date of the receipts may be taken as March 1st in each case.

3 months to June 30th: Black, 150,000 yards, £6,562.
White, 350,000 yards, £17,500.

Due date in each case May 1st.

White charged sundry expenses in the 3 months to March 31st, £60, and for the 3 months to June 30th, £75.

Stock is to be valued at 6d. per yard.

Black purchased a Motor Delivery Van on February 1st, at a cost of £500, valued as on March 31st at £400. Black agreed to take this van over as on June 30th, at a valuation of £200.

NOTE.—In the illustration, the accounts of the joint venture in the books of Black and of White are ruled off at March 31st and June 30th, to indicate the entries made in the accounts before and after the combined Joint Venture Account has been prepared.

Black's Books.

JOINT VENTURE WITH WHITE.

Dr.

Date	Particulars	Mths.	Interest £	s.	d.	£	s.	d.
19... Jan. 1	To Cash, Purchase of Linen, and Carriage	3	375	12	0	25,040	0	0
,, 1	,, Discounting Charges	3		10	6	35	0	0
,, 31	,, Warehousing and Office Expenses	2	1	0	0	100	0	0
Feb. 1	,, Motor Delivery Van	2	5	0	0	500	0	0
,, 28	,, Warehousing and Office Expenses	1		10	0	100	0	0
Mar. 31	,, Warehousing and Office Expenses					100	0	0
,, 31	,, Interest					382	12	6
						£26,257	12	6
19... Mar. 31	To Balance brought down ..					6,107	12	6
,, 31	,, Profit and Loss Account, profit to date					7,852	1	0
						£13,959	13	6
19... April 1	To Stock brought down	3	187	10	0	12,500	0	0
,, 1	,, Motor Van	3	6	0	0	400	0	0
,, 30	,, Warehousing and Office Expenses	2	1	0	0	100	0	0
May 30	,, Warehousing and Office Expenses	1		10	0	100	0	0
June 30	,, Warehousing and Office Expenses					100	0	0
,, 30	,, Interest					195	0	0
						£13,395	0	0
19... June 30	To Balance brought down ..					6,767	7	7
,, 30	,, Profit and Loss Account, profit to date					6,619	11	5
						£13,386	19	0

Cr.

Date	Particulars	Mths.	Interest £	s.	d.	£	s.	d.
19... Jan. 1	By Bill Receivable, due Feb. 1st	2	100	0	0	10,000	0	0
Mar. 1	,, Cash (Sales)	1	50	0	0	10,000	0	0
,, 31	,, Interest					150	0	0
,, 31	,, Balance carried down					6,107	12	6
						£26,257	12	6
19... Mar. 31	By Stock carried down .. .					12,500	0	0
,, 31	,, Motor Van at valuation ..					400	0	0
,, 31	,, Cash from White					1,059	13	6
						£13,959	13	6
19... May 1	By Cash (Sales)	2	65	12	5	6,562	0	0
June 30	,, Interest					65	12	5
,, 30	,, Balance carried down					6,767	7	7
						£13,395	0	0
19... June 30	By Motor Van taken over					200	0	0
,, 30	,, Cash from White					13,186	19	0
						£13,386	19	0

White's Books.

JOINT VENTURE WITH BLACK.

Dr.		Mths.	Interest. £	s.	d.	£	s.	d.			Mths.	Interest. £	s.	d.	£	s.	d. Cr.
19... Jan. 1	To Bill Payable, due Feb. 1st ..	2	100	0	0	10,000	0	0	19... Mar. 1	By Cash (Sales)	1	84	7	6	16,875	0	0
Feb. 1	„ Cash, Advertising Charges ..	2	5	0	0	500	0	0	„ 31	„ Interest					84	7	6
Mar. 31	„ Sundry Expenses					60	0	0									
„ 31	„ Interest					105	0	0									
„ 31	„ Balance carried down					6,294	7	6									
					£	16,959	7	6						£	16,959	7	6
19... Mar. 31	To Profit and Loss Account, profit to date					5,234	14	0	19... Mar. 31	By Balance brought down .					6,294	7	6
„ 31	„ Cash to Black					1,059	13	6									
						£6,294	7	6							£6,294	7	6
19... June 30	To Sundry Expenses					75	0	0	19... May 1	By Cash (Sales)	2	175	0	0	17,500	0	0
„ 30	„ Balance carried down					17,600	0	0	June 30	„ Interest					175	0	0
					£	17,675	0	0						£	17,675	0	0
19... June 30	To Profit and Loss Account, profit to date					4,413	1	0	19... June 30	By Balance brought down ..					17,600	0	0
„ 30	„ Cash to Black					13,186	19	0									
					£	17,600	0	0						£	17,600	0	0

Black and White.

JOINT ADVENTURE IN LINEN.

Dr.		Mths.	Interest. £	s.	d.	£	s.	d.			Mths.	Interest. £	s.	d.	£	s.	d. Cr.
19... Jan. 1	To Purchase of Linen and Carriage	3	375	12	0	25,040	0	0	19... Mar. 1	By Sales, 500,000 yds.	1	134	7	6	26,875	0	0
,, 1	,, Discounting Charges	3		10	6	35	0	0	,, 31	,, Stock, 500,000 yds. at 6d. ..					12,500	0	0
,, 31	,, Warehousing and Office Expenses	2	1	0	0	100	0	0	,, 31	,, Motor Van at valuation ..					400	0	0
Feb. 1	,, Advertising Expenses	2	5	0	0	500	0	0	,, 31	,, Interest (Balance to contra) .		253	5	0			
,, 1	,, Purchase of Motor Van ..	2	5	0	0	500	0	0									
,, 28	,, Warehousing and Office Expenses	1		10	0	100	0	0									
Mar. 31	,, Warehousing and Office Expenses					100	0	0									
,, 31	,, Sundry Expenses					60	0	0									
,, 31	,, Interest (Balance from contra)					253	5	0									
						26,688	5	0									
,, 31	,, Profit : Black, 3/5ths					7,852	1	0									
	White, 2/5ths					5,234	14	0									
		£	387	12	6	39,775	0	0			£	387	12	6	39,775	0	0
19... April 1	To Stock, 500,000 yds. at 6d. ..	3	187	10	0	12,500	0	0	19... May 1	By Sales, 500,000 yds.	2	240	12	5	24,062	0	0
,, 1	,, Motor Van	3	6	0	0	400	0	0	June 30	,, Motor Van					200	0	0
,, 30	,, Warehousing and Office Expenses	2	1	0	0	100	0	0	,, 30	,, Interest (Balance from contra)					45	12	5
May 31	,, Warehousing and Office Expenses	1		10	0	100	0	0									
June 30	,, Warehousing and Office Expenses					100	0	0									
,, 30	,, Sundry Expenses					75	0	0									
,, 30	,, Interest (Balance to contra) ..		45	12	5												
						13,275	0	0									
,, 30	,, Profit : Black, 3/5ths					6,619	11	5									
	White, 2/5ths					4,413	1	0									
		£	240	12	5	24,307	12	5			£	240	12	5	24,307	12	5

EXAMINATION QUESTIONS.

1. Baker and Brown are partners in a joint venture in connection with a cargo of goods offered by Stone & Co., on the basis that Baker is to buy and sell, and for such services, receive 5 % of the net profits, if any; the remaining profits, or the loss, to be divided as to Baker $\frac{4}{7}$ths and Brown $\frac{3}{7}$ths. The following are the transactions: 19... May 1st, Bought from Stone & Co., Goods T.60, £60,000; May 2nd, Brown handed to Baker, £5,000; May 4th, Paid Stone & Co., on account, £6,000; May 9th, Parker Bros., paid on account, £10,000; May 10th, Sold Goods to Parker Bros., T.20, £25,000; May 11th, Sold Goods to Rivers & Co., T.30, £33,000; Parker Bros. returned damaged goods, T.1, £1,250; May 15th, Sold Goods to Rivers & Co., T.9, £11,000; May 26th, Received from Parker Bros., £13,750; May 27th, Paid Stone & Co., £12,000; May 28th, Sold for Cash, T.2, £750; Received from Rivers & Co., £44,000; May 30th, Paid Stone & Co., £42,000; Out of Pockets charged by Baker, £100; May 31st, Baker paid Brown balance due to him.

Make the necessary entries in Baker's books and prepare a general statement showing the result of the venture. (*Institute Book-keepers.*)

2. Black and White entered into partnership upon equal terms as to profits or losses of the venture, for the purpose of perfecting an invention with a view to its sale to a Syndicate. No interest was to be paid upon Partners' Capital prior to division of results. Black contributed £300 and White £150 to cover the cost of experiments, White giving his personal services without salary.

Upon the completion of the necessary experiments the purchases and expenses were found to have amounted to £478. Black then advanced a further £50, and White paid £22 for Patent fees, etc.

The invention was sold by them to a Syndicate for £1,000 in cash, which was paid to them, and 1,000 fully paid shares of £1 each in the Syndicate, and these were duly allotted.

Upon dissolving the partnership, White arranged to take over the stock of materials at an agreed valuation of £36, and undertook to discharge outstanding liabilities (if any). Black consented to take over the £1,000 fully paid shares at an agreed valuation of £50.

Prepare the accounts necessary upon the dissolution of partnership. (*Royal Society of Arts.*)

3. Mr. John Black and Mr. Edward Thompson agree to import Swedish timber into this country. On May 1, 19.., they open a Banking Account under the style of "Black & Thompson" for £2,400, towards which John Black contributes £1,400 and Edward Thompson £1,000, they dividing profits or losses *pro rata* to their cash contributions (say $\frac{7}{12}$ths and $\frac{5}{12}$ths respectively). They remit to their agent in Sweden £1,800 to pay for the timber purchased out there, and, later on, a further £100 in settlement of his account. The Freight, Insurance, and Dock Charges are all paid on this side, and, together, amount to £400. On December 31, 19.., the various sales have realized £2,400 net, which enables them to repay themselves (taking no account of interest) the cash respectively advanced by them on May 1, 19... The venture is then closed by John Black taking over the balance of timber unsold for £380, and for which he pays a cheque into the Banking Account. How much Cash Balance does this leave for final division by way of profit, and how is the same apportioned between John Black and Edward Thompson as their respective share of profit thus realized on the venture? (*Institute of Bankers.*)

4. Brown and Jones engage in a joint speculation in timber, the former being in Russia and the latter in England. A banking account in their joint names is opened on February 10, 19... Brown pays in £500 and Jones

£660. The following are the transactions: 19.. February 15th, Bought cargo in Riga from L. Sandherr valued £632, less discount at 5 %, £600 8s.; Accepted Sandherr's draft at 3 m/d, £600 8s.; February 17th, Paid expenses loading at Riga, £28 9s. 6d.; Paid freight to Hull, £98 17s. 9d.; March 23rd, Sold Robinson logs, £165 18s.; Received cash, less 2½ %, £157 12s. 2d.; March 24th, Bought from M. Reimann for cash cargo of timber, net £933; April 29th, Paid shipping charges and freight, £213; April 24th, Sold M. Johnson deals, net £337; Received his acceptance at 2 months, £337; May 17th, Sold J. James cargo purchased from Reimann, net £1,260; Received his acceptance at 1 month, £1,260; June 30th, Stock, balance of Sandherr's cargo, valued at £311. On June 30th the speculation was closed by Jones taking over the stock at the agreed value of £311, less 10 %. Adjust the accounts as between the partners at June 30, 19.., allowing interest on the amounts deposited at 5 %. (*Chartered Accountants.*)

CHAPTER IX

JOINT STOCK COMPANIES

COMPANY FORMATION

[NOTE.—The references are to the *Companies Act*, 1929, unless otherwise stated.]

THE trading records of Joint Stock * Companies, whatever the particular business carried on, are precisely the same as those of sole traders, or partners conducting similar businesses. Apart, however, from the usual commercial books of account, there are, in the case of companies, certain books and registers which need to be specially considered. Some of these books and registers are obligatory under statute, while others, as will be explained later, are convenient in use and save time.

Definition.—A Joint Stock (or Incorporated) Company consists of a body of persons united for certain definite purposes under royal or legislative sanction, in such manner that they form a corporate body, i.e. an entity recognised in law as a distinct legal personality capable of holding property in its own right, of incurring obligations, and of suing and being sued in its own name. Subject to its Memorandum and Articles of Association, a Limited Company has the same contractual powers as a firm or private person.

Methods of Incorporation.—Companies may be incorporated in one of three ways, viz. by

(*a*) *Royal Charter.*—This method is, nowadays, rarely adopted except in the case of companies formed for Colonial development. The East India Company (1600) and The Hudson's Bay Company (1670) were incorporated under Royal Charter. A modern example is The British South Africa Company (1889).

(*b*) *Special Act of Parliament.*—The Bank of England (1694) and such undertakings as the British Railways afford examples of this mode of incorporation.

(*c*) *Registration under "The Companies Act,* 1929."—The vast majority of companies in existence to-day are controlled by this Act. The aggregate capital of the Companies registered under the Act exceeds £4,000,000,000.†

* "Stock" had not formerly its present limited meaning. A joint stock company meant originally a partnership in which all the members paid their funds to a common stock for the purpose of trade, as distinguished from "regulated" companies, trading with foreign parts, in which, subject to bye-laws, each member traded on his own account.

† The first of the Company Acts of Parliament was passed in the year 1844. In 1855, the principle of limiting the liability of the members of a

Kinds of Joint Stock Companies.—There are three classes of Joint Stock Companies, viz. :—

(*a*) Companies limited by *Shares*.
(*b*) Companies limited by *guarantee* (with or without a share capital).
(*c*) Companies the liability of whose members is *unlimited* (with or without a share capital).

In class (*b*) the Memorandum of Association limits the liability of the members to the definite amount which each undertakes to contribute to the assets in the event of the liquidation of the company while he is a member, or within one year of his having ceased to be a member (S. 2 [3]). In class (*c*) no limit is attached to the liability of the members. Both these classes, (*b*) and (*c*), are quite unsuitable for commercial undertakings, and are so seldom met with that no further consideration will be given to them in this volume. It is with the formation and administration of companies limited by shares, class (*a*), that this and the succeeding chapters are concerned, for the vast majority of incorporated companies in existence to-day are so limited.

Advantages of Registration.—Registration as a Company confers many advantages not possessed by a firm or sole trader. Registration facilitates the raising of fresh capital, increases financial resources, and so enhances credit, expedites extensions and amalgamations, and permits arrangements to be made for employees to acquire an interest in the business. The death or bankruptcy of members does not affect a company's existence, neither does the transfer of its shares from one person to another. Doubtless, however, the most popular advantage is the limitation of the liability of the members with the ensuing protection of their personal estates. Briefly stated, no member of a company limited by shares can be called upon to contribute any sum beyond the nominal value of the shares he has agreed to take. When once he has paid the full nominal value of the shares for which he has subscribed, he is entirely relieved from any further claim to contribute towards the company's liabilities. He may lose the capital he has invested should the company fail, but no matter how involved

joint stock company incorporated by registration was introduced. The first great Company Consolidation Act was passed in 1862. From that date up to the year 1908 some sixteen amending Acts were passed. The provisions of those Acts, known as "*The Companies Acts*, 1862–1908," were, with additions and amendments, re-enacted in the great Consolidation Statute of 1908. Three further amending Acts were passed which, with the Act of 1908, were known as "*The Companies Acts*, 1908–1917." In 1928, a further, and most important, amending Act was passed to bring Company Law into line with present day requirements. The whole of the Acts were then consolidated in *The Companies Act*, 1929.

in debt the company may become the amount of his subscription to the capital fund marks the limit of his liability.*

Illustration.—On April 1st, Rayon d'Or, Ltd., offered for public subscription 100,000 ordinary shares of £1 each, payable as to 5s. per share on application, 5s. per share on allotment, and 10s. per share on May 1st. On April 2nd, George Dickson sent in an application for 100 shares together with his cheque for £25 (5s. per share application money). On April 5th, the 100 shares were allotted to him, and on the day following he forwarded a further £25 (5s. per share allotment money). On May 1st, he forwarded £50, being the final call of 10s. per share. George Dickson's liability on the dates mentioned was as follows :—

April 5th. £75, i.e. £100 less £25 application money paid.
April 6th. £50, i.e. £75 less £25 allotment money paid.
May 1st. Nil, the balance of £50 having then been paid.

However unfortunate the history of Rayon d'Or, Ltd., may subsequently prove to be, no further claim can be made against George Dickson, since he has paid for his 100 shares in full.

The only events in which the shareholders' liability may become unlimited are :—

(*a*) If at any time the number of members of a company is reduced, in the case of a private company, below two, or, in the case of any other company, below seven, and it carries on business for more than six months while the number is so reduced, every member of the company during the time that it so carries on business after those six months who is cognisant of the fact of the reduction in membership below two or seven as the case may be shall be severally liable for the payment of the whole debts of the company contracted during that time (S. 28).

(*b*) Under Section 146, the liability of directors, managers, or managing directors may be unlimited if so provided by the memorandum—a seldom-used provision.

The idea, at one time prevalent, that registration as a limited company would adversely affect the credit of the undertaking has largely died out. There is no doubt that in earlier days dishonest people converted their businesses into limited companies in order to escape their liabilities. Usually, the consideration money took the form of debentures, and the claims of unsecured creditors were thus defeated. In several cases, e.g. *In re* Hirth [1899] and *In re* Goldburg [1912], such schemes were held to be fraudulent conversions, or acts of bankruptcy, and the practice was killed. Registration places information at the disposal of the public through the documents filed † at Somerset House, and a solvent business gains rather than loses the confidence of its creditors from the easy access to the filed documents.

* The liability of the members of a limited company carrying on the business of banking, and issuing notes, is, in respect of the note issue, unlimited.

† The word "filed" is employed to mean "delivered to the Registrar of Companies for registration."

Company Contrasted with Firm.—It may be useful to set out in tabular form the main distinctions between a company limited by shares and a partnership.

Partnership.	*Limited Company.*
(*a*) The partners in a firm are individuals acting together in partnership as they may mutually agree amongst themselves, or, in the absence of agreement, in accordance with the *Partnership Act*, 1890, or agreement may be implied by a course of dealing. If they so desire, partners may vary the terms of the Act in certain respects. The capital of a firm may be increased or decreased by agreement between the partners, or by trading gains or losses. A firm is not in England a separate entity, although in Scotland it is. The members of a partnership may not exceed twenty in number, and if the business carried on be banking they may not exceed ten.	(*a*) A company is a legal entity in itself, distinct from the members who hold shares in it. It is governed by the Act of 1929, which it cannot override. Its powers are determined by its Memorandum of Association, and can be altered only by sanction of the Court. Its capital is fixed by its Memorandum and cannot be altered except under the powers conferred by Statute. There is no limit to the number of shareholders (except in private companies), but the statutory minimum number of shareholders must be maintained, i.e. seven in a public and two in a private company.
(*b*) The liability of a partner (except a limited partner) is co-extensive with the whole of his property. Every partner in a firm is jointly liable with his co-partners (in Scotland severally also) for all the debts and obligations of the firm incurred while he is a partner. Judgment obtained against a firm is judgment against all the partners of the firm jointly.	(*b*) The liability of a shareholder is limited to the amount which he has agreed to contribute to the capital of the company, and when he has paid that amount to the company, no further liability attaches to him. Judgment obtained against a company is not judgment against the shareholders individually, but against the company in its corporate capacity.
(*c*) All partners (except limited partners) can take part in the management of the business of the firm; and all have access to its books. A partner can bind the firm and his co-partners so long as he acts within the ordinary scope of the business, or within the special authority delegated to him by his co-partners. He is an agent of the firm and his co-partners for the purposes of the business of the partnership. A limited partner, however, can only "advise," for, if he takes any part in the management of the business, he becomes liable as a general partner.	(*c*) A shareholder has no power to bind the company, or to bind his co-shareholders; nor has he any right to take part in the management of the company, or to inspect its books, except as may be allowed by the Articles. The conduct of a company's business devolves upon the Directors. The acts of the Directors are governed by the Articles of the company, and these cannot be altered except by special resolution passed by the shareholders in general meeting. A shareholder's influence is confined to his vote on the occasion of ordinary or extraordinary general meetings convened by the Directors, or in certain cases provided by Statute, by the members themselves, if the directors default in calling such meetings.

(*d*) A partner cannot, except by agreement with his co-partners, substitute another partner for himself. A limited partner, however, cannot prevent a general partner from transferring his share. The death, bankruptcy, or retirement of a partner (where these events do not result in the winding-up of the partnership), or the bringing in of a new partner, has the effect of creating a new firm.	(*d*) A shareholder can transfer his shares as he pleases, subject to the Articles of Association, which, in the case of a private company, must restrict transfers. No matter what changes may occur in the personnel of the shareholders of a company, the corporation remains the same entity.
(*e*) It is not obligatory on a firm to appoint auditors or to hold meetings.	(*e*) A limited company must annually appoint auditors, and must hold certain meetings.
(*f*) Partners can make any agreement they choose, and can vary the terms of the partnership when and as they please.	(*f*) Companies are bound by their Memorandum and Articles, and though the latter may be varied there are some things not allowed, e.g. the company may not buy its own shares.
(*g*) There is no Statutory provision requiring a partnership to keep books of account, although it is practically essential, and the failure to keep books may be an offence if the firm becomes bankrupt.	(*g*) A limited company must keep proper books of account, and prepare a Profit and Loss (or Income and Expenditure) Account and Balance Sheet every year. Severe penalties attach to default in this respect.
(*h*) A partnership can be brought to an end by agreement at any time.	(*h*) A limited company can only be brought to an end by being struck off the Register by order of the Court or where it has ceased to function, or by being wound up by the Statutory Process.

Statutory (or Parliamentary) Company.—These companies are quite distinct from Joint Stock Companies incorporated under the Act of 1929. They are incorporated by Acts of Parliament specially passed for the regulation of certain classes of enterprises, the majority of which are formed for the purpose of undertaking work of a public character, e.g. Railway, Gas, Water, Dock and Harbour Works. They are not required to add the word "Limited" to their names, and are not bound to permit inspection of their share registers as other Joint Stock Companies are. But they must keep open for inspection without charge a Shareholders' Address Book. Table A does not apply to these companies, which are governed by the somewhat antiquated regulations contained in the various *Companies Clauses Consolidation Acts*, 1845–1889, so far as the special acts of the undertakings do not exclude or modify them.

Forming a Company.—Any *seven* or more persons may combine

to form and register a *public* company; any *two* or more may form and register a *private* company.

No partnership of more than *ten* persons shall be formed to carry on the business of banking unless it is incorporated (S. 358); and no partnership of more than *twenty* persons shall be formed for carrying on any other business that has for its object the acquisition of gain unless it is incorporated, or is a company engaged in working mines within the Stannaries [mines in Devon and Cornwall], and subject to the jurisdiction of the court exercising the Stannaries jurisdiction (S. 357).

If a company continues to trade after its membership has fallen below seven in the case of a public company and two in the case of a private company, penalties attach to the remaining members and the company may be wound up (S. 168 [4]).

Usual Procedure in Formation of Company.—The usual steps in the formation of a public company limited by shares are to prepare:—

(1) The Memorandum of Association, and the Articles of Association. (2) The preliminary contracts. (3) A statement of the nominal capital. (4) A list of the persons who have consented to act as directors. (5) Where the directors are appointed by the Articles they must, either personally or by an agent authorised in writing, sign and file (*a*) a written consent to act as directors, and (*b*) if they have not signed the Memorandum for their qualification shares they must sign a contract to take and pay for the necessary shares (S. 140). (6) The statutory declaration that all the requirements of the Act have been complied with.

All the above documents must be duly signed and stamped and lodged with the Registrar of Joint Stock Companies, who, if satisfied that everything is in order, issues, on the second official day after the fees and duties are paid, a certificate that the company is incorporated and is limited. From the date of incorporation mentioned in the certificate, the subscribers to the Memorandum, and all other persons who may from time to time become members of the company, are a body corporate having perpetual succession and a common seal but with such liability to contribute to the assets of the company in the event of its being wound up as is mentioned in the Act (S. 13). The company has also power to hold lands (S. 14).

The next step is to obtain the necessary capital. This is effected by the preparation and issue of a *Prospectus*, containing such particulars as are required by the Act, inviting the public to subscribe for the whole of the company's share capital or debentures, or part thereof. The prospectus cannot be issued until a copy signed by each Director or proposed Director named therein has been duly filed with the Registrar.*

* In order to save time, the prospectus is sometimes registered prior to incorporation.

Should the issue prove successful, i.e. should (*a*) the amount stated in the Prospectus as the *minimum subscription* upon which the directors may proceed to allotment be taken up by the public, and (*b*) the amount payable on application on each share, which must not be less than 5 % of the nominal value of each share, has been paid to and received by the company, then the directors may proceed to allotment (S. 39).

A public company which does not issue a prospectus, or which has issued a prospectus but has not proceeded to allot any of the shares offered to the public for subscription, must at least three days before the first allotment of any of its shares or debentures file with the Registrar a *Statement in Lieu of Prospectus* signed by every director or proposed director of the company in the form and containing the particulars set out in the Fifth Schedule to the Act (S. 40).

The company having been duly incorporated and the required capital having been subscribed by the public, a statutory declaration must be filed that (*a*) the minimum subscription * has been allotted, and that (*b*) every director has paid to the company in cash the same proportion per share on the shares taken or contracted to be taken by him for cash as is payable by the public per share on application and allotment, or in the case of a public company not issuing a Prospectus on the shares payable in cash. Thereupon, the Registrar shall certify that the company is entitled to commence business and the certificate shall be conclusive evidence of the fact (S. 94).

A public company may simultaneously issue both shares and debentures. The provisions as to minimum subscription apply only to a first allotment of shares offered to the public for subscription and not at all to a debenture issue. But in the case of a second or subsequent offer of shares, the amount offered for subscription on each previous allotment made within the two preceding years, and the amount actually allotted, and the amount, if any, paid on the shares so allotted must be stated in the prospectus (Fourth Schedule, Part I, 6).

Public Company.—There is no statutory definition of a public company, but it may be assumed that, in a legal sense, any company which invites public subscription of its shares is a public company,† and, for the purposes of the Act, every company which does not satisfy the requirements of a private company is a public company. Although only seven members are necessary to form a public company, the number of members may be increased to any extent, so long as the total amount of the shares issued by a company does not exceed

* The statutory declaration filed by a company which has filed a statement in lieu of prospectus does not refer to "minimum subscription," which applies only to companies issuing a prospectus.

† Before 1907 every limited company was technically a public company, and there was no difference as regards legal requirements, though the expression "private company" was in use for a company which made no appeal to the public for capital.

the total capital which it is authorised to issue by its Memorandum of Association.

Private Company.—Section 26 defines a private company as one which by its Articles of Association:—

(*a*) Restricts the right to transfer its shares; and

(*b*) Limits the number of its members to fifty, not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in such employment, and *have continued* after the determination of that employment to be, members of the company; and

(*c*) Prohibits any invitation to the public to subscribe for any shares or debentures of the company.

The documents required on registration of a private company are: (1) Memorandum, (2) Articles, (3) Statement of Nominal Capital, (4) Statutory Declaration.

Every private company must send with the annual return required to be filed under S. 110, a certificate signed by a director or the secretary that the company has not, since the date of the last return, or in the case of a first return since the date of incorporation, issued any invitation to the public to subscribe for any shares or debentures of the company; and, *where the return of members discloses the fact that* the number of members of the company exceeds fifty, also a certificate to certify that such excess consists wholly of persons who are to be excluded in reckoning the number of fifty (S. 111).

Two persons suffice to form a private company in place of the *seven* required for a public company. If a private company alters its Articles so that they no longer include the provisions which constitute it a private company, it immediately ceases to be a private company, and must file a prospectus or a statement in lieu of prospectus within fourteen days of the alteration. (The form of statement in lieu is set out in the Third Schedule.) If a private company fails to comply with the provisions of its Articles of Association which confer upon it the privileges of a private company it ceases to be entitled to the exceptions granted by the Act though, where the failure was inadvertent, the Court has power to relieve the company from its consequences (S. 27).

Joint holders of shares in a private company count as one person (S. 26 [2]).

Private companies prove increasingly popular, especially in connection with "family" businesses. By registering such a business as a company, the owner can enjoy the advantages of a partnership without its attendant risks of unlimited liability. He can admit his employees to a share in the business, and can divide his capital amongst the members of his family without disturbing the financial arrangements of the business, or burdening the beneficiaries with unlimited liability.

A private company enjoys certain advantages and exemptions that a public company does not enjoy. It is exempt from the obligation to file a prospectus or a statement in lieu of a prospectus (S. 40), or the annual balance sheet (S. 110), or the form of consent to act on behalf of the directors (S. 140). It is under no obligation to fix a minimum subscription, and it can commence business and exercise any borrowing powers immediately on registration (S. 94). A private company need not hold a statutory meeting or file or circulate the statutory report that a public company must file and circulate (S. 113).

A private company is exempt from the provision that every company registered after 31st October, 1929, must have at least two directors (S. 139). Unless its Articles so provide, a private company need not circulate to its members a copy of its balance sheet, but any member is entitled to be furnished, within seven days after he has made a request in that behalf to the company, with a copy of the balance sheet and auditor's report at a charge not exceeding sixpence for every hundred words (S. 130).

One Man Company.—The capital of a private company is frequently held almost entirely by one man, the other signatory to the Memorandum of Association required to make up the statutory number, or more signatories if there be more, being merely his nominee or nominees. Hence the term " One Man Company." This term has, however, no legal significance. The legal designation is " Private Company." The suspicion which in earlier days attached to the term " One Man Company " has to a large extent been lived down.

Memorandum of Association.—This is a company's charter of incorporation. It sets forth the conditions on which the company exists and defines its objects. All acts exceeding the powers taken in the Memorandum are *ultra vires* the company, i.e. beyond its powers, and are consequently null and void.

The Memorandum of a company limited by shares must state :—

(*a*) The name of the company with " Limited " as the last word in its name.

(*b*) Whether the registered office of the company is to be situate in England or in Scotland.

(*c*) The objects of the company.

(*d*) That the liability of the members is limited.

(*e*) The amount of share capital with which the company proposes to be registered, and the division thereof into shares of a fixed amount.

No subscriber to the Memorandum, i.e. the seven or the two signatories, may take less than one share, and each subscriber must write opposite to his name the number of shares he takes (S. 2). The Memorandum must be stamped as a deed, and be signed by each subscriber in the presence of at least one witness who must attest the signature (S. 3).

Name of Company.—A company may not be registered by a name identical with the name of a company already registered, or so nearly resembling that name as to be calculated to deceive, except where the company in existence is in the course of being dissolved and signifies its consent in such manner as the Registrar requires. The words "Chamber of Commerce" may only be used as part of the name of a company registered under a licence from the Board of Trade to dispense with the word "Limited." The words "Building Society" are forbidden. Such words as "Royal," "Imperial," "Municipal," "Chartered," "Co-operative," etc., may not form part of the name without the consent of the Board of Trade (S.17). The words "Red Cross" cannot be used without the authority of the Army Council. Certain other words are also protected by various Acts. The name of an existing firm cannot be taken if the public will be misled.

Any company may, by passing and registering a special resolution with the written approval of the Board of Trade thereto, change its name (S. 19 [1]). If, however, the name originally registered is so nearly like that of an existing business name as to be calculated to deceive, only the consent of the Registrar is necessary (S. 19 [2]). A new certificate of Incorporation is issued upon any change of name taking place.

A company must paint or affix its name in letters easily legible on the outside of every office or place where it carries on business; have its name engraven in legible characters on its seal; mention its name in legible characters in all notices, advertisements, and official publications of the company, and in all bills of exchange, promissory notes, endorsements, cheques, etc., and in all invoices and receipts (S. 93).

The abbreviation "Ld." or "Ltd." appears to be legal, but not in the Memorandum itself, where the word must be spelt in full. The word "Limited" may be dispensed with where it is proved to the satisfaction of the Board of Trade that the company is to be formed for promoting commerce, art, science, religion, charity or any other useful object, and intends to apply its profits or other income in promoting its objects, and to prohibit the payment of any dividend to its members, and the Board of Trade has issued a permissive licence (S. 18).

Registered Office.—The Memorandum states the *part* of Great Britain (England or Scotland) where the registered office is situate. By S. 92, every company must, as from the day on which it begins to carry on business or as from the twenty-eighth day after the date of its incorporation, whichever is earlier, have a registered office to which all communications and notices may be addressed, and notice of the situation of the registered office or any change therein must be given within twenty-eight days after the date of incorporation or of any change to the Registrar of Companies who must record it. The registered office of a company is its official residence where writs may be properly served.

Objects of the Company.—The objects of a company must be legal, i.e. they must not be contrary to public policy or forbidden by Statute. A company cannot legally undertake any business other than that which by its objects clause it takes power to transact. The objects clause cannot be altered except by special resolution confirmed by the Court, and then only to enable it (*a*) to carry on its business more economically or efficiently; (*b*) to attain its main purpose by new or improved means; (*c*) to enlarge or change the local area of its operations; (*d*) to carry on some business that may conveniently or advantageously be combined with its existing business; (*e*) to restrict or abandon any of its objects; (*f*) to sell or dispose of the whole or any part of its undertaking; (*g*) to amalgamate with any other company or body of persons (S. 5). In order to avoid the irksome and expensive procedure required for alteration of the objects clause, it is usual to make this clause as wide as possible, so as to cover all the business that a company is likely to undertake. It is anomalous that, on an alteration under S. 5, an amended copy of the Memorandum must be *printed* for filing, although the original may be hand-written or typed.

Share Capital.—The amount of capital which a company takes power in its Memorandum to issue is known as its nominal, registered, or authorised capital. If so authorised by its Articles originally, or as altered for the purpose by special resolution, a company may (*a*) increase its capital; (*b*) consolidate and divide all or any of its share capital into shares of larger amount; (*c*) convert its paid-up shares into stock and re-convert that stock into paid-up shares of any denomination; (*d*) sub-divide its shares or any of them into shares of smaller amount; (*e*) cancel shares that have not been taken up or agreed to be taken up, and so diminish its capital by the amount of the cancelled shares (S. 50). The powers conferred by S. 50 must be exercised by the company in general meeting (S. 50 [2]). Usually a company takes power in its Articles to do all of these things.

If so authorised by its Articles originally, or as altered by special resolution for the purpose, a company may by special resolution after confirmation by the Court reduce its share capital *in any way*, and in particular by (*a*) extinguishing or reducing the liability on any of its shares in respect of share capital not paid up; (*b*) with or without extinguishing or reducing liability on any of its shares, cancel paid-up share capital which is lost or unrepresented by available assets; (*c*) with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the company's wants (S. 55). A special resolution under S. 55 is called "a resolution for reducing share capital." But a cancellation of shares under S. 50 is not deemed to be such a resolution (S. 50 [3]).

Variation of Shareholders' Rights.—If the Memorandum or Articles contain provisions for varying the rights of any class of shareholders subject to the consent of any specified proportion of the holders

of the issued shares of that class or the sanction of a resolution passed at a separate meeting of the holders of those shares, and at any time the rights are so varied, the holders of not less in the aggregate than fifteen per cent. of the issued shares of that class, being persons who did not consent or vote in favour of the resolution for the variation, may apply to the Court to have the variation cancelled. The variation cannot then take effect until confirmed by the Court, which will examine the circumstances and may disallow the variation if it thinks it would unfairly prejudice the shareholders of the class. A copy of the order of the Court must be filed within fifteen days (S. 61).

A company may by special resolution determine that any specified portion of its share capital not called up shall not be capable of being called up except in the event and for the purpose of the company being wound up (S. 49).

Redeemable Preference Shares and the issue of shares at a discount are dealt with at pp. 301 and 303.

Articles of Association.—These comprise the rules and bye-laws which regulate the internal government of a company and its members. Table A, contained in the First Schedule to the Act of 1929, is a model set of 107 Articles. A company may adopt that table wholly; or adopt it to the extent that it satisfies its requirements, framing special articles to meet special needs; or draw up and register its own special set of articles. But no modified or special article may contravene the general law, or conflict with the provisions of the Companies Act. If no special Articles are filed, the Memorandum must be indorsed "Registered without Articles," and in that case every member of the company is bound by Table A.

A private company *must* have articles, since its regulations must include restrictions and prohibitions which are not contained in Table A.

It is worthy of note that, under S. 6, every unlimited and every guarantee company (with or without a share capital) must file articles.

The Articles and the Memorandum when registered bind the company in its dealings with members, and each member in dealing with the company or with fellow members, just as if each member had covenanted to be bound by them, but they do not bind the company or its members to non-members of the company.

Every person dealing with a company is deemed to have had notice of the contents of its Articles and Memorandum, since these are registered and available for perusal.

Provided that the acts of a company are within the powers of its Memorandum and Articles, a non-member is entitled to assume in his dealings with the company that the directors have been properly appointed and have acted regularly, unless he has had notice actual or constructive to the contrary.

The Articles may be read in order to explain any ambiguity in the Memorandum, or to supplement the Memorandum with regard to

points on which that document is silent. Memorandum and Articles are within these limits construed together. Where they are inconsistent the Memorandum prevails.

Articles must (*a*) be printed, (*b*) divided into consecutively numbered paragraphs, (*c*) stamped as a deed, (*d*) signed by each subscriber of the Memorandum in the presence of at least one witness who must attest the signature (S. 9).

Subject to the provisions of its Memorandum, a company may by special resolution alter or add to its articles, provided the alterations or additions do not contravene the provisions of the Act (S. 10), or the general law, or entail a breach of contract, and are made *bona fide*, and for the benefit of the company as a whole.

A private company must file Articles of Association comprised in which must be clauses (*a*) restricting the right to transfer its shares, (*b*) limiting the number of members exclusive of employees and ex-employees to fifty, (*c*) prohibiting invitation to the public to subscribe for its shares or debentures. A private company may not issue share warrants, for such an issue would defeat the restriction upon the transfer of shares.

A company's Articles deal, *inter alia*, with such matters as (1) Definition of terms. (2) Exclusions or modifications of Articles in Table A. (3) Regulations as to capital. (4) Payment of underwriting commission. (5) Borrowing powers. (6) Regulations as to the issue of shares; lien on shares; calls on shares; transfer and transmission of shares; forfeiture of shares; conversion of shares into stock; issue of share warrants; rights of the holders of different classes of shares; alterations of share capital. (7) General meetings and the proceedings thereat. (8) Voting powers of members. (9) The number, remuneration, qualification, and powers and duties of Directors. (10) Affixing the company's seal. (11) The disqualification, rotation, and proceedings of Directors. (12) The declaration and payment of dividends, and the provision of reserves. (13) The preparation of the company's accounts. (14) Audit of the company's books. (15) Issue of notices by the company.

A company is bound to send to every member on his request a copy of its Memorandum and Articles at a charge not exceeding one shilling, and a copy of any Act of Parliament which alters the memorandum at a charge not exceeding the published price of that Act (S. 23).

Prospectus.—The issue of prospectuses is governed by SS. 34 and 35 of the Act. The expression "Prospectus" means any prospectus, notice, circular, advertisement, or other invitation, offering to the public for subscription or purchase any shares or debentures of a company (S. 380). The common form of these documents, though somewhat abbreviated, is amply illustrated in the public Press and need not be set out here. Their object, of course, is to induce the public to take shares or debentures.

Considerable responsibility attaches to those who authorise the issue of a prospectus. Misrepresentation in a prospectus of material matters of fact, or misrepresentation by the omission of material facts, whether fraudulent or innocent, entitles a shareholder who applies for shares on the faith of the prospectus to bring an action against the company for rescission of his contract to take the shares, and for interest on the amount paid for them, at (as in *Karberg's* case, 1892) 4% per annum. But he must act within reasonable time, and before winding-up proceedings have begun, and do nothing that can be construed as an adoption of the contract (e.g. attempt to sell the shares) or the right to rescission is gone.

In addition, he may bring an action against every director, promoter, and other person, who has authorised the issue of the prospectus for loss or damage sustained by reason of any untrue statement on a material matter contained therein. Such action may be brought under the common law, or under S. 37 of the Act, and after liquidation proceedings have commenced as well as before. But the action will fail if the persons sought to be charged can show that (*a*) they had reasonable grounds for believing that the statements made were true, or (*b*) that they withdrew their consent to become directors before the issue of the prospectus, and that it was issued without their authority or consent, or (*c*) that it was issued without their knowledge or consent and they gave public notice of this, or (*d*) that, having become aware of the untrue statement after issue of the prospectus and before allotment, they then withdrew their consent, and gave reasonable public notice of the withdrawal and the reason therefor.

The measure of damages is usually the difference between the true value of the shares at the time of allotment and the price paid for them; and this, at the highest, may be the full nominal value of the shares.

Usually, the rights of rescission, and of action for damages at common law, or for compensation under S. 37, are capable of exercise by original allottees only.

It should hardly be necessary to remind the professional student that if the prospectus contains an accountant's report, the report should be based upon facts and not upon estimates.

Statutory Requirements.—The following statutory requirements must be fulfilled :—

(*a*) Every prospectus must bear a date, and unless the contrary be proved, that date is taken to be the date of publication.

(*b*) A copy must be signed by every person named therein as a director or proposed director and filed with the registrar on or before the date of its publication, and a statement that a copy has been duly filed must appear on the face of the prospectus.

(*c*) Except when the prospectus is published as a newspaper advertisement, it must state the contents of the Memorandum, the names, descriptions, and addresses of the signatories, and the

number of shares subscribed for by them respectively. It must also state the number of founders or management or deferred shares, if any, and the nature and extent of the interest of the holders in the property and profits of the company.

(*d*) It must state the names, descriptions, and addresses of the directors or the proposed directors, the number of shares, if any, fixed by the articles as the qualification of a director, and any provisions in the articles as to the remuneration of directors.

(*e*) The minimum subscription (i.e. the minimum amount which, in the opinion of the directors, must be raised by the issue of shares to the public in order to provide the sums, or, if any part thereof is to be defrayed in any other manner, the balance of the sums, required to be provided in respect of each of the following matters:

(i) The purchase price of any property purchased or to be purchased which is to be defrayed in whole or in part out of the proceeds of the issue;

(ii) Any preliminary expenses payable by the company, and any commission so payable to any person in consideration of his agreeing to subscribe for, or of his procuring or agreeing to procure subscriptions for, any shares in the company;

(iii) The repayment of any moneys borrowed by the company in respect of (i) or (ii); and

(iv) Working capital)

on which the directors may proceed to allotment; the amounts to be provided in respect of the matters stated above, otherwise than out of the proceeds of the issue and the sources out of which those amounts are to be provided; and the amount payable on application and allotment on each share.

(*f*) In the case of a second or subsequent offer of shares, the amount offered for subscription on each previous allotment made within the two preceding years, the amount actually allotted, and the amount, if any, paid on the shares so allotted; and the number and amount of shares and debentures which within the two preceding years have been issued or agreed to be issued as fully or partly paid up otherwise than in cash, and in the latter case the extent to which they are paid up, and in either case the consideration for which they have been issued or are proposed to be issued.

(*g*) The names and addresses of the vendors of any property purchased or acquired or proposed to be purchased or acquired by the company and to be paid for wholly or partly out of the proceeds of the issue for which subscription is invited by the prospectus, and the amount payable in cash, shares, or debentures to the vendor, and where there is more than one separate vendor or the company is a sub-purchaser the amount so payable to each vendor, and, separately stated, the amount (if any) payable for goodwill in respect of such property.

(*h*) The amount paid within the two preceding years, or payable, as underwriting or other commission for subscribing or procuring subscriptions for shares or debentures in the company, or the rate of any such commission. (Sub-underwriting commission need not be stated.)

(*i*) The amount or estimated amount of the preliminary expenses.

(*j*) The amount paid within the two preceding years or to be paid to any promoter and the consideration for such payment.

(*k*) The dates of and parties to every material contract together with reasonable time when and place at which a copy thereof may be inspected, except in the case of contracts entered into in the ordinary course of the company's business, or more than two years before the date of the issue of the prospectus.

(*l*) The names and addresses of the auditors (if any).

(*m*) Full particulars of the nature and extent of the interest (if any) of every director in the promotion of, or in the property proposed to be acquired by, the company, together with a statement of all sums paid or agreed to be paid to him in cash or shares or otherwise by any person either to induce him to become, or to qualify him as a director, or otherwise for services rendered by him in connexion with the promotion or formation of the company. (If the interest of the director consists in being a partner in a firm, the interest of the firm must be stated.)

(*n*) Where the company's shares are of more than one class, the right of voting conferred by, and the rights in respect of capital and dividends attached to, the several classes of shares respectively.

(*o*) A report by the auditors of the company with respect to the profits of the company in each of the three financial years immediately preceding the issue of the prospectus, and with respect to the rates of the dividends, if any, paid by the company in respect of each class of shares in the company in respect of each of the said three years, giving particulars of each such class of shares on which such dividends have been paid and particulars of the cases in which no dividends have been paid in respect of any class of shares in respect of any of those years, and, if no accounts have been made up in respect of any part of the period of three years ending on a date three months before the issue of the prospectus, containing a statement of that fact.

(*p*) If the proceeds, or any part of the proceeds, of the issue of the shares or debentures are or is to be applied directly or indirectly in the purchase of any business, a report made by accountants who shall be named in the prospectus upon the profits of the business in respect of each of the three financial years immediately preceding the issue of the prospectus.

In (*o*) and (*p*) above, if the company or business has been carried on for less than three years, the report must cover such less period. The provisions with respect to the memorandum and the qualifica-

tion, remuneration and interest of directors, the names, descriptions and addresses of directors or proposed directors, and the amount or estimate of the preliminary expenses, do not apply in the case of a prospectus issued more than two years after the date on which the company is entitled to commence business.

Statement in Lieu of Prospectus.—Public companies which do not issue a prospectus must, under S. 40, file with the registrar a *Statement in Lieu of Prospectus* in the form and containing the particulars set out in the Fifth Schedule of the Act of 1929. Briefly stated, the requirements of this document are similar to those required for the prospectus itself, viz. nominal share capital and the classes of shares into which it is sub-divided; names, descriptions, and addresses of the directors; voting, capital and dividend rights of the several classes of shares; number and amount of shares and debentures issued as fully or partly paid otherwise than in cash, and the consideration therefor; names and addresses of vendors, and the amount in cash, shares, or debentures payable to each, specifying, separately, the amount (if any) payable for goodwill; amount payable for underwriting or other commission for subscribing or procuring subscriptions for shares or debentures of the company or the rate of the commission; number of shares, if any, which persons have agreed for a commission to subscribe absolutely; estimated amount of preliminary expenses amount paid, or intended to be paid, to any promoter and the consideration therefor; dates of and parties to every material contract and time and place when and where the contracts or copies of them can be inspected; names and addresses of the auditors (if any); particulars of the nature and extent of the interest of every director in the promotion of, or in the property to be acquired by, the company; if it is proposed to acquire any business, the amount, as certified by the auditors of that business, of the net profits for each of the last three financial years, or such less period as the business has been carried on.

Promoter.—The person who does the preliminary work in the flotation of a company and sets it going is called the "promoter." "The term 'Promoter' is a term not of law but of business, summing up in a single word a number of business operations, familiar to the commercial world, by which a company is brought into existence." He secures, e.g., a contract to acquire the business or property which the company is to take over, attends to the preparation of Memorandum and Articles; to finance; and to registration of the company.

A promoter stands in a fiduciary position towards the company and may not make any *secret* profit for himself out of the promotion, or otherwise benefit himself at the expense of the company. He must disclose to the company every material fact that the company has a right to know. Action will lie against a promoter who has made a secret profit, the measure of damages being the amount of that profit less reasonable expenses incurred in connection therewith.

Preliminary Contracts.—These are agreements entered into prior to the formation of a company, between vendors of property to be acquired by the company and the company itself, or with an agent acting for the company. The company is not bound by such agreements until the directors have adopted them by entering into a new contract based upon new consideration after the company has been incorporated. And until that has been done the company cannot sue the vendors. An agent acting for the company is personally bound by such agreements, and, usually, he protects himself by taking power in the agreement to rescind them should the company not be incorporated, or not proceed to allotment within a reasonable time.

Preliminary Expenses.—These comprise, *inter alia*, the cost of preparing and printing the Memorandum, the Articles, and the Prospectus, and of circulating and advertising the Prospectus; the cost of registering the company and the statutory documents, together with fees and stamp duties payable thereon; the cost of drawing up the preliminary contracts and stamp duties thereon; cost of printing and stamping debentures (if any) and of share certificates and letters of allotment; cost of the seal and original books of the company; and (separately stated) the amount paid or payable to any promoter, and for underwriting commission; law costs in connection with all or any of these matters. Preliminary expenses are not allowed as a charge against profits for income tax purposes, except expenditure incurred in purchasing books of account, stationery, the company's seal, and the like.

The promoter usually undertakes liability for these expenses in the first place, and looks to the company to relieve him of it, after incorporation. But vendors acting also as promoters not infrequently undertake to defray these expenses out of the purchase consideration received by them from the company. In order to make his own position secure a promoter must take care that he is in a position to compel the company as soon as it is incorporated to enter into a binding agreement to discharge these expenses. An agreement made prior to incorporation by a company cannot be ratified. A new agreement based upon new consideration * must be entered into by the company after incorporation. Where a company does not proceed to allotment, the promoter is personally liable for the preliminary expenses, except in so far as he has contracted out of this liability, e.g. with printers, etc.

Vendor.—Part III, Fourth Schedule (2) defines a vendor as every person who has entered into any contract, absolute or conditional, for

* It is usual to bring in this new consideration by including preliminary expenses with property being transferred, or by the promoter making payment of the preliminary expenses part of a contract for continuing services with the company. But it is usual for the company's objects to include the payment of the preliminary expenses, and the need for the new agreement does not then arise.

the sale or purchase, or for any option of purchase, of any property to be acquired by the company, in any case where:—

(*a*) The purchase money is not fully paid at the date of the issue of the prospectus;

(*b*) The purchase money is to be paid or satisfied wholly or in part out of the proceeds of the issue offered for subscription by the prospectus;

(*c*) The contract depends for its validity or fulfilment on the result of that issue.

Where a company is to take property on lease, the lessor is a vendor, and the purchase money is the consideration for the lease.

It is not necessary to state in the prospectus the names and addresses of every vendor or sub-vendor, and the amount, whether it be in cash, shares or debentures, which each is to receive, provided the property acquired is paid for in cash prior to the issue of the prospectus, but even then there is a duty to disclose such contracts in the prospectus, if they are material contracts; to state the dates and the parties to them, and a reasonable time and place at which they (or copies) may be inspected.

Directors.—The persons appointed to manage the affairs of a company on behalf of the general body of shareholders are called the *Directors* or, collectively, *The Board of Directors*, or, shortly, *The Board*. Every public company registered after 31st October, 1929, must have at least two directors (S. 139).

Directors may be appointed by (*a*) the signatories to the Memorandum, (*b*) the Articles, (*c*) the directors themselves, in the case of a vacancy, (*d*) the members in general meeting, (*e*) a third party empowered by the Articles to appoint. Frequently, the Articles state that the first directors of the company shall be appointed by the signatories to the Memorandum. If that be so, a formal letter is signed by all the signatories, or by a majority, if power is so given by the Articles, appointing certain persons as directors. This document should be pasted in the Minute Book.

The directors' powers and duties are defined, and their remuneration is fixed, by the Articles. Every director must qualify himself within two months of appointment by acquiring the number of shares fixed by the Articles as to the qualification of a director (S. 141). The Articles of most companies fix the minimum number of shares which each director must hold. But where a company has deleted Table A, and made no provision in its special Articles for qualification shares, it would appear to be able to elect non-members as directors. Table A, clause 66, provides that directors must hold at least one share. A person must not be named as director or proposed director of a company in a prospectus issued by or on behalf of the company before the expiration of one year after its becoming entitled to commence business,

or in a statement in lieu of prospectus filed by the company, unless he has by himself or his agent authorised in writing, signed and filed a written consent to act and either

(i) signed the memorandum for a number of shares not less than his qualification, if any; or
(ii) taken from the company and paid or agreed to pay for his qualification shares, if any; or
(iii) signed and filed a contract to take from the company and pay for his qualification shares, if any; or
(iv) made and filed a statutory declaration to the effect that the requisite shares are registered in his name (S. 140).

A director who ceases to hold the necessary qualification shares vacates office (S. 141).

Besides the ordinary supervision of the commercial activities of the company, the directors' duties include: the issue of capital; allotment of shares; making of calls; forfeiture of shares; passing of transfers; issue of certificates; issue of debentures; calling of meetings; ensuring that proper accounts are kept; recommendation of dividends, etc.

Directors are special agents of the company, but they do not incur personal liability on any contracts they may enter into if they act within their authority and the powers of the company. It would appear from the decision in *Lagunas Nitrate Co.* v. *Lagunas Nitrate Syndicate*, 1899, that directors incur no personal liability for mistakes and errors of judgment, if they act within their powers, and honestly, and with reasonable care, unless the mistake was "in a business sense culpable or gross." Every director must disclose to the Board the nature of his interest in any contract or proposed contract. This can be done by giving a general notice that he is a member of a specified company or firm (S. 149).

Any provision to pay compensation for loss of office to directors of a company whose undertaking is in whole or in part being transferred to another company or person, is illegal unless approved by the company (S. 150). The office of director can be assigned only when approved by special resolution (S. 151). The Articles usually provide that a proportion of the directors shall retire annually, and either be re-elected, or their places be filled by other directors appointed by the members in general meeting, the Board having power to fill casual vacancies. An undischarged bankrupt can only act as director with the leave of the court (S. 142).

Every company registered after 22nd November, 1916, every foreign company establishing a place of business in Great Britain, and every company registered under the *Moneylenders Act*, 1927, must disclose on its notepaper, and in trade catalogues, circulars, etc., the name of every director, and his nationality if he is not British, and his former nationality if his nationality is not the nationality of origin.

Directors are not entitled to be paid their fees "free of income tax," unless allowed by the Articles, and, if the Articles are silent, they must be altered before this concession is permissible (*Boschoeck Proprietary Co.* v. *Fuke*, [1926]). It would appear, however, that the company in general meeting can vote the amount of the tax as a bonus. Neither are directors entitled to expenses unless voted by the shareholders or sanctioned by the Articles. Even where expenses are allowed they do not cover the cost of travelling to and from board meetings unless expressly provided for in the Articles (*Young* v. *Naval, etc., Society*, [1905]).

The directors must, on a demand made to them in writing by members entitled to not less than one-fourth of the voting power of all the company's members, furnish to such members within one month from the receipt of the demand a statement certified by the auditors showing as respects each of the last preceding years in respect of which the accounts of the company have been made up the aggregate amount received in that year by way of remuneration or other emoluments by directors of the company, including remuneration received by any director from a subsidiary company (see p. 465 for definition) of which he is also director or from any company of which he is a director as a nominee of the company. The demand can be overridden if the company in general meeting within the month resolve that the statement be not furnished. It is sufficient if the statement contains the aggregate sum paid to all directors in each year without specifying the amount received by any individual. The remuneration includes any tax paid on behalf of the director by the company and any other emoluments and the money value of any allowances or perquisites attaching to the office (S. 148).

Managing Director.—The majority of companies take power in their Articles to appoint one (or more) of their number as Managing Director(s) and to fix his or their remuneration. In such cases some of the duties of the Board are frequently delegated to the Managing Director(s). It is also usual to provide that, while such managing directors continue in office, they shall not need to come up for re-election in order of rotation as do the other directors.

Common Seal and Contracts.—The common seal with the company's name engraved thereon in legible characters, which, by S. 93, a company is bound to keep, is the company's official signature. It is impressed upon all share and debenture certificates, and upon all contracts, which, if entered into between private persons, would have to be in writing and executed under seal. The Articles usually provide that the seal shall be affixed in the presence of two directors and the secretary of the company, and that after affixation the document shall be signed by them. It is usual to keep a register of sealed documents. The use of the seal is safeguarded by its being kept under lock and key.

Contracts which if made between private persons must by law be in writing and signed but need not be under seal, must in the case of companies be in writing, and signed by someone acting under its express or implied authority. Contracts which between private persons may be made by parol (orally) may in the case of companies be made by parol by any authorised person (S. 29).

Official Seal.—A company whose objects require or comprise the transaction of business in foreign countries may, if authorised by its articles, have for use in any territory, district or place not situate in the United Kingdom, an official seal, which must be a facsimile of the common seal, with the addition on its face of every territory, district or place where it is to be used. By writing under its common seal, the company can authorise any person appointed for the purpose to affix the official seal to any deed or other document to which the company is party in that territory, district or place. The authority of such agent as between the company and any persons dealing with the agent continues during the period mentioned in the instrument conferring the authority, or if no period is mentioned, until notice of the revocation has been given to the person dealing with him. The agent must, by writing under his hand, certify on the deed or other document, the date and place of affixing the official seal. Any deed or other document so sealed and certified binds the company as if sealed with the common seal (S. 32).

Underwriting.—In these days, few public companies are formed without the whole or part of the capital issue having been previously underwritten. This term means that certain persons termed *Underwriters* have entered into a contract with the company to subscribe for any shares or debentures which are not taken up by the public, in consideration for which the company undertakes to pay to them a commission termed *Underwriting Commission.* Underwriting commissions vary from 1 % to 10 %, according to the risk attaching to the issue, and may be paid in cash or by way of fully paid shares. Payment of underwriting commission is, practically, an insurance to secure the success of a capital issue.

It is a common practice to sell the whole issue of shares or debentures to a financial house, termed an *Issuing House,* which, in turn, offers the shares or debentures to the public. The Issuing House can then make an "offer for sale." Such an offer was formerly not deemed to be a prospectus. S. 38 of the Act of 1929, however, extends the provisions governing a prospectus to such an offer.

The payment of underwriting commission is *ultra vires* unless it is authorised by the Articles and disclosed in the Prospectus or Statement in Lieu, and the rate paid does not exceed the rate authorised by the articles (which must not exceed 10 per cent.) (S. 43). The amount so paid must be separately stated in the Balance Sheet, or so much thereof as has not been written off, until the whole has been written off (S. 44).

Illustration.—A. B. undertakes to underwrite the whole of an issue of 10,000 ordinary shares to be issued by Blanks, Ltd. The public subscribe for 5,000 shares only. Under his agreement, therefore, A. B. must take up the balance of 5,000 shares.

An underwriter is only responsible *pro rata*. Thus if the share issue of Blanks, Ltd., was £50,000, and A. B. agreed to underwrite half the issue, and the public subscribed for £40,000, then A. B. would be relieved to the extent of £20,000, and would have to subscribe for £5,000 only, unless his agreement provided otherwise.

Underwriters frequently place a portion of the risk assumed by them with others, termed *Sub-Underwriters*, with whom they share their commission. In such cases the underwriters are usually paid an additional *Overriding Commission* of small amount.

The cost of the underwriting may be borne by the promoter. If so, it does not concern the company. But if the company bears the cost, an account must be opened for underwriting commission, and, when complete, the balance should be transferred to Preliminary Expenses Account. The provisions of S. 44, however, must not be overlooked.

Illustration.—Blanks, Ltd., enter in an agreement with the X. Y. Promoting Syndicate, Ltd., to underwrite an issue of 50,000 of their ordinary shares of £1 each for an underwriting commission of 4 % and an overriding commission of 1 %. The Syndicate underwrites £20,000 of the issue, and places the balance of £30,000 on sub-underwriting terms with A, B, C, and D. The commission payable will be as follows :—

	£	s.	d.
X. Y. Promoting Syndicate.			
4 % Underwriting Commission, and 1 % Overriding Commission on £20,000 (i.e. 5 % in all)	1,000	0	0
1 % Overriding Commission on £30,000, sub-underwritten with A, B, C, and D	300	0	0
	1,300	0	0
A, B, C, and D.			
4 % on £30,000 sub-underwritten	1,200	0	0
Total commission payable	£2,500	0	0

The subject of underwriting and sub-underwriting has become somewhat complicated, and the student who wishes to pursue the subject further is referred to the author's *Accounting*, pp. 124–6.

Brokerage.—Brokerage is distinct from underwriting commission, but examination candidates often confuse the two. Underwriting commission may only be paid under the conditions named above, but brokerage may be paid by any company. The offer to pay brokerage appears in most prospectuses. Its payment is recognised by S. 43, ss. 3, and is within the power of limited companies (*Metropolitan Coal Consumers' Association* v. *Scrimgeour*, [1895]). It consists of a small sum, e.g. threepence per share, paid to stockbrokers and others for placing shares with their clients. The brokers send copies of the prospectus, with their rubber stamp on the application form, to their

clients. If shares are allotted to the applicants on these forms, the brokers must be credited with the brokerage due to them, and Preliminary Expenses Account be debited with a like amount.

The rate of brokerage paid must be "reasonable," e.g. in the *Metropolitan, etc.*, case (*supra*) $2\frac{1}{2}$ % was held to be reasonable.

Auditors.—The auditors of a company are officers of the company in so far as audit of the company's accounts is concerned (*London and General Bank*, [1895]; *Kingston Cotton Mill Co., Ltd.*, [1896]). They are also agents for the shareholders.

Every company must at each annual general meeting appoint an auditor or auditors to hold office until the next annual general meeting. The remuneration of the auditor so appointed is fixed by the shareholders, though it is common for the shareholders to re-appoint the auditors "at a fee to be fixed by the Directors." * If no auditor is appointed, the Board of Trade, on the applicaton of any member, may appoint an auditor and fix his remuneration (S. 132). The following persons cannot act as auditor:—

(*a*) a director or officer of the company;
(*b*) except where the company is a private company, a partner or employee of an officer of the company;
(*c*) a body corporate (S. 133).

But the first auditors of the company may be appointed before the first annual general meeting by the directors, who may fix their remuneration. These hold office until the first annual general meeting, unless they are previously removed by resolution of the shareholders in general meeting. If they are so removed the shareholders at that meeting may appoint others in their place. The directors may fill any casual vacancy in the office of auditor, but while there is a vacancy the continuing auditors (if any) may act (S. 132).

No person, other than a retiring auditor, shall be appointed auditor unless notice of the intention to nominate that person has been given by a shareholder fourteen days before the annual general meeting, and the company has sent a copy of the notice to the retiring auditor, and has given notice to the shareholders, not less than seven days before the meeting. If notice has been given to the company, and the Directors call the meeting for a date fourteen days or less after notice was given, this does not invalidate the notice, which can be sent to the members with the notice calling the meeting (S. 132, ss. 3). These provisions have proved salutary safeguards in cases where unscrupulous directors have endeavoured to replace inconveniently conscientious auditors by others more pliable to their wishes.

The auditor has at all reasonable times right of access to the books, accounts, and vouchers of the company, and he may require directors

* It is not clear how far this delegation of duty is strictly legal, though the custom is very general.

and other officers of the company to furnish him with such information and explanations as he may require (S. 134, ss. 2). No article which attempts to limit or interfere with the rights of an auditor is valid (*Newton* v. *Birmingham Small Arms Co., Ltd.*, [1906]).

The auditor must make a report to the shareholders on the accounts examined by him and on every Balance Sheet laid before the company in general meeting. A copy of this report must be attached to every such Balance Sheet. The report must be read at the annual general meeting. In it the auditor must state whether or not he has obtained all the information and explanations he has required, and whether, in his opinion, the Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of his information and the explanations given to him, and as shown by the books of the company (S. 134, ss. 1).

The auditors are entitled to attend any general meeting of the company at which any accounts which have been examined or reported on by them are to be laid before the company and to make any statement or explanation they desire with respect to the accounts (S. 134 ss. 3).

Every company other than a private company, must, not less than seven days before the meeting, send to all persons entitled to receive notices of general meetings a copy of every balance sheet, including the documents required by law to be annexed thereto (see p. 499), which is to be laid before the company in general meeting, together with a copy of the auditor's report. Any member and any debenture holder is entitled to be furnished on demand, without charge, similar copies. In the case of a private company, any member may demand a copy of the balance sheet and auditor's report on payment of a charge not exceeding sixpence for every hundred words (S. 130).

In ordinary circumstances, the auditor's report usually takes the following form :—

To the Shareholders of Blanks, Ltd.

We report to the shareholders as follows : We have audited the above Balance Sheet dated. . . . We have obtained all the information and explanations we have required. In our opinion, such Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs according to the best of our information and the explanations given us and as shown by the books of the Company.

In appropriate cases, the Report may also state :—

We have also verified the Bank balance and the Investments.

If the auditors wish to qualify their report in any respect, the attention of the shareholders is drawn to the fact by the insertion of some such clause as follows :—

Subject to proper provision for Depreciation of the Machinery and Plant, such Balance Sheet is, etc.

Auditors are not responsible for the method of presenting a company's accounts; neither can they dictate the form those accounts shall take. But they can decline to certify accounts which, in the form presented, are in their opinion misleading. The accounts are the accounts of the Directors, and only for grave reasons have the auditors power to interfere with the form of their presentation. The auditors must report wherein the accounts do not conform with the Act, and, in particular, with S. 128 (see p. 498).

The duties of auditors cannot be dealt with at length in this place. Brief extracts from the *dicta* of British judges may, however, be usefully quoted :—

> "His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that." (*London and General Bank, Ltd.*, [1895].)
>
> "Auditors of a limited company are bound to know, or make themselves acquainted with, their duties under the articles of the company whose accounts they are appointed to audit and under the Companies Acts." (*Republic of Bolivia Exploration Syndicate, Ltd.*)
>
> "That it is the duty of a company's auditor in general to satisfy himself that the securities of the company in fact exist and are in safe custody cannot, I think, be gainsaid. . . . The duty of the auditor is to verify the facts which it is proposed to state in the balance sheet, and in doing so to use reasonable and ordinary skill." (*City Equitable Fire Insurance Co., Ltd.*)
>
> "It is no part of an auditor's duty to take stock. . . . He must rely on other people for details of the stock-in-trade on hand." (*Kingston Cotton Mill Co., Ltd.*, [1896].)
>
> "It is the duty of an auditor to bring to bear upon (his) work . . . that skill, care, and caution which a reasonably competent, careful, and cautious auditor would use. What is reasonable . . . depends upon the circumstances of each case. . . . Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud, *when there is nothing to arouse their suspicion*, and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors." (*Kingston Cotton Mill Co., Ltd.*, [1896].)
>
> "An auditor . . . is bound to make a reasonable and proper investigation of the accounts and of the stock sheets so far as he can, and if a reasonable and prudent man would have come to the conclusion that there was something wrong, then it is his duty to call the attention of his employers to it, and in that consideration he is entitled to take into account the fact that the documents are vouched for by trusted servants of his employers. . . . They are entitled to rely on the certificate of the managers. . . . It was their duty to a certain extent to examine the accuracy of the certificate." "Although it is quite clear that it is not the duty of an auditor to take stock, one cannot say that it may not be his duty to call attention to suspicious items appearing in the stock sheets." (*Mead v. Ball, Baker & Co.*)

The Secretary.—The secretary is an agent of the company for the particular duties he is deputed to perform, and the executive officer of the Directors to whom he is responsible. It is his duty to ensure that the Directors' instructions are passed on to, and carried out by, the staff. He must see that the company fulfils all legal re-

quirements, and that the provisions of the Memorandum and Articles are complied with. In particular, it is his duty to conduct the general correspondence of the company; to prepare the agenda for directors' and general meetings, and to record accurate minutes of the proceedings at these meetings; to see that the statistical books are properly kept; to satisfy himself that transfers are in order before bringing them before the directors to be passed; and (usually) to sign or countersign all cheques, share certificates, dividend warrants and similar documents, after having previously verified them before sealing and/or signature by the directors.

Subscription List.—The prospectus inviting public subscription to the company's capital issues having been circulated, the next step is to prepare the *Subscription List.* This usually takes the form of separate *Application and Allotment Sheets* for the different classes of shares, suitably ruled to record the necessary particulars. The prospectus usually includes a printed *Application Form.* This is filled in by the applicant, and sent, together with the amount payable per share on application, to the company's bankers. A specimen Application and Allotment Sheet, and an Application Form, are shown on pp. 288–9.

The Subscription List is usually open for three days, unless closed earlier because the issue has been fully subscribed. But country applications received by the first post on the day following the closure of the list are usually also considered. When the list has been closed, the application forms are handed over by the bankers to the company. These should be numbered and checked with the Bank Pass Book,* from which, in due course, the Shareholders' Cash Book is written up. In many cases it is more expeditious to add a column to the Application Book (or sheets) for use as a Shareholders' Cash Book. The Allotment Sheets are prepared from these materials for the consideration of the Directors who allot the shares at their discretion. This proceeding is known as *going to allotment.* Frequently preference is given to those applicants likely to prove most useful to the company as customers or otherwise. In cases where an issue is over-subscribed, the shares are sometimes distributed *pro rata* amongst the applicants.

When a portion of the capital of a company remains unissued, the directors have power, either under the Articles, or after a special resolution has been passed, to issue the balance of shares whenever it may seem expedient to do so in the interests of the company. But they must recognise their fiduciary position as directors, and act *bona fide*

* It is convenient to arrange for the bank to prepare loose sheets rather than a bound pass book. The sheets can then be collected at convenient hours and the work of tabulating, etc., is expedited. Such sheets will, of course, shortly be the standard form of presentation by the bank of a copy of the entries in their customer's account.

in the interests of the company as a whole. They may not, for example, issue the shares in order that they themselves or their friends may take them up and obtain control of the undertaking (*Cook* v. *Barry, Henry, & Cook, Ltd.*, [1923]) or prevent another person from becoming a director.

The act of allotment, which is duly recorded in the Minutes, signifies the acceptance by the Directors of the offers of the applicants to take shares, and the contract is complete as soon as the allotment letter is posted.

No allotment can take place unless the minimum subscription (if any) has been secured, and the application moneys, which must not be less than 5 % of the nominal value of the shares, have been received by the company.

Letter of Regret.—When no allotment of shares is made to an applicant, a letter of regret, together with a cheque returning the application money, is sent to him. A record of every such transaction is made on the Application Sheets. Such a letter is illustrated on p. 291.

Return of Allotments.—Within one month of the completion of allotment, or within one month of any subsequent allotment, a return, bearing a 5s. stamp, must be filed with the Registrar in order to satisfy the requirements of S. 42 of the Act. The front page of this return is reproduced on p. 290, the other pages consist of a list of the names, addresses, and descriptions of the allottees with the number and class of shares held by them.

Allotment Letters.—After allotment has been made, an Allotment Letter is sent to each successful applicant. These documents must be stamped with 1d. if under £5, and with 6d. if over that amount. The posting of an allotment letter completes the contract to take shares as between the company and the applicant. An applicant may withdraw his application at any time prior to the posting of the letter, but not afterwards, unless he can prove misrepresentation in the prospectus or other irregularity entitling him to be relieved of his contract. An allotment letter is illustrated at p. 292.

Calls.—The prospectus of a new issue usually states the dates on which further instalments of the purchase price of shares are to be paid. For example, " The ordinary shares of £1 each shall be payable as follows: upon application, 2s. 6d.; upon allotment, 5s.; on October 25th, 5s.; on November 25th, 7s. 6d."

If no dates are specified, these instalments are payable at the discretion of the Directors after they have given due notice of the call, usually fourteen days or more. Under Table A and, as a rule, under special articles, no single call may exceed 25 % of the nominal value of the share, and calls are made at intervals of two months. (Under Table A the interval must be at least one month.) Shares with an uncalled liability attached to them are not popular, except, perhaps,

[*Continued at foot of p. 293.*

(*Form of Application for Shares with Receipt Form.*)

RAYON D'OR, LIMITED.

(*Incorporated under the Companies Act*, 1929.)

This form must be sent *entire* direct to the Company's bankers, the National Provincial Bank, Ltd., Princes Street, London, E.C., together with a remittance for the deposit of *2s. 6d.* per share on the shares applied for. Cheques should be made payable to the Bankers, or *Bearer*, and crossed "Not Negotiable."

TO THE DIRECTORS OF RAYON D'OR, LTD.

GENTLEMEN,

Having paid to your Bankers, the National Provincial Bank, Ltd., the sum of £ : : , being a deposit of 2s. 6d. per share on .... shares, which I hereby apply for, I request that you will allot to me such shares, upon the terms of the Company's Memorandum and Articles of Association and the prospectus issued by you and dated .... 19..

I hereby undertake to accept such shares, or any less number you may allot to me, and I authorise you to place my name on the Register of Members of the Company in respect of the shares allotted to me.

Signature of Applicant ....

Name (in full) ....

Address ....

....

Occupation ....

(A lady should state whether Spinster, Wife, or Widow.)

Date .... 19...

---(*Perforation.*)---

(Bankers' Receipt, to be detached and retained by Bankers.)

RAYON D'OR, LIMITED.

RECEIVED this .... day of .... 19.. *of* M.......... .... the sum of .... being 2s. 6d. per share upon .... shares applied for in the above Company.

For the National Provincial Bank, Ltd.

Stamp.

Cashier

This receipt must be preserved by the applicant, to be exchanged in due course for the share certificate.

RAYON D'OR, LIMITED.

ISSUE OF 50,000 ORDINARY SHARES OF £1 EACH.

APPLICATION AND ALLOTMENT SHEETS

Date of Application.	No. of Application.	Name of Applicant.	Address.	Occupation.	No. of Shares Applied for.	Amount Paid on Deposit .. per Share.				Date of Allotment.	No. of Shares Allotted.	Distinctive Numbers.		No. of Allotment Letter.	Amount Payable on Application and Allotment.			
						C.B. folio.	Amount.					From	To		Date Paid.	Amount.		
							£	s.	d.			NOTE.—In cases where there are several classes of shares, it is advisable to carry the numbering through continuously—e.g. Ordinary Shares, 1 to 100,000; Preference Shares, 100001 to 200000, and so on. This prevents confusion between the different classes of shares in subsequent transfer work				£	s.	d.

Date and No. of Letter of Regret.	Amount returned to Applicant.					Amount Paid in Advance of Calls.			No. of Share Certificate.	Folio in Share Register.	Remarks.	Balance due on Allotment.				
	Date.	C.B. folio.	Amount.									Date Paid.	C B. folio.	Amount.		
			£	s.	d.	£	s.	d.			NOTE.—This column is used specially to earmark any forms bearing the initials of the directors or other applications which need special consideration.			£	s.	d.

Number of Company ....   [Form No. 45.

THE COMPANIES ACT, 1929.

RETURN OF ALLOTMENTS

OF

................................, LIMITED,

from the †...... day of.........., 19 ,

to the.......... day of.........., 19 ,

A Companies Registration Fee Stamp of 5s. must be impressed here.

Made pursuant to Section 42, Sub-section 1, of the Companies Act, 1929.

(To be delivered to the Registrar of Companies within one month after the Allotment is made.)

* Distinguish between Preference, Ordinary, Redeemable Preference, or other descriptions of shares.

*Number of the .... Shares allotted payable in Cash ....

*Number of the .... Shares allotted payable in Cash ....

*Nominal Amount of the .... Shares so allotted .. £........

*Nominal Amount of the .... Shares so allotted .. £........

*Amount paid or due and payable on each such .... Share .. .. £........

*Amount paid or due and payable on each such .... Share .. .. £........

Number of Shares allotted for a consideration other than Cash .. .. } ....

Nominal Amount of the Shares so allotted .. .. £........

Amount to be treated as paid on each such Share .. £........

The consideration for which such Shares have been allotted is as follows:—

....

....

....

....

† NOTE.—In making a return of Allotments it is to be noted that—

1. When a return includes several Allotments made on different dates, the dates of only the first and last of such Allotments should be entered at the top of this page, and the registration of the return should be effected within one month of the first date.

2. When a return related to one Allotment only, made on one particular date, that date only should be inserted and the spaces for the second date struck out and the word "made" substituted for the word "from" after the name of the Company.

(*Letter of Regret.*)

Directors:
(Names)

RAYON D'OR, LTD.,
962 FINSBURY CIRCUS,
LONDON, E.C.
January 14, 19...

1 *Enclosure.*

SIR (or MADAM),

I am instructed by the Directors of the above Company to express regret that they are unable to allot any shares to you in response to your application of ....

Enclosed I have pleasure in handing you a cheque for £ : : , being the amount paid by you on application.

Kindly sign the receipt attached at the foot hereof and present the enclosed cheque for payment in due course.

Yours faithfully,
ROBERT WOOD,
Secretary.

To ....

....

....

(*Perforation.*)

No. 3841.

LONDON .... 19..

TO THE NATIONAL PROVINCIAL BANK, LTD.

Pay to .... or Order, the receipt below being duly signed, the sum of £ : : .

For and on behalf of
RAYON D'OR, LTD.
JAMES BURGET, *Director.*
ROBERT WOOD, *Secretary.*

(*Perforation.*)

RECEIPT.

RECEIVED from Rayon d'Or, Limited, the sum of £ : : being the amount deposited by me on application for .... shares not allotted.

Receipt Stamp.

£

(*Call Letter.*)

No. *36*.

RAYON D'OR, LIMITED,
962 FINSBURY CIRCUS,
LONDON, E.C.
July 4, 19..

Directors:
(Names)

ORDINARY SHARES.

DEAR SIR (or MADAM),

I beg to inform you that in accordance with a resolution of the Directors dated July 2, 19.., a call of 5s. per share on the above shares has been made.

The amount due from you in respect of the *100* shares standing in your name is *£25 0 0*, and this amount should be sent on or before July 18, 19.., together with this notice *entire* to the Company's Bankers, the National Provincial Bank, Ltd., Princes Street, E.C., who will receipt and duly return this notice.

If you will forward the receipt attached hereto, together with your share certificates, the payment of the call will be indorsed, and the certificate returned to you.

By order of the Board,
James Conolly,
Secretary.

GEORGE DIXON, ESQ.,
1754 CANNON STREET,
E.C.

All cheques should be made payable to BEARER and crossed "Not negotiable."

No. *36*.

RECEIVED for account of Rayon d'Or, Limited, the amount of the above-mentioned call as stated.

For National Provincial Bank, Ltd.,
Robert Craig,
Cashier.
Date, *July* 18, 19...

No. *36*.

RAYON D'OR, LIMITED.

Call of 5s. per share on issue of 100,000 Ordinary Shares.

£25 0 0

Date, July 18, 19...

Continued from p. 287.]
in the case of bank shares. Calls are specialty debts, and are therefore not statute barred until after the lapse of twenty years. It would appear that calls must be made on the subscribers to the Memorandum. Apparently they are not liable to pay for their shares until calls have been made upon them (*Alexander* v. *Automatic Telephone Co.*). A specimen call notice appears above.

Uprichards, Limited.

CALL LIST.

Second Call of 2*s*. 6*d*. per Share Date of Call, *March 1*, 19... Due *March 17*, 19...

Number of Call Note.	Folio Register of Members.	Shareholder.	Address.	Shares Held.	Amount of Call. £	s.	d.	When Paid. Amount. £	s.	d.	When Paid. Date.	C.B. Folio.	Remarks.
3	47	*Robinson, William*	*436 Duke Street, E.C.*	120	15	0	0	15	0	0	*Mar. 14*		

Making a Call.—When the Directors have passed the necessary resolution making a call, a *Call List* should be prepared in the form appearing on this page.

Large companies open a separate banking account and a subsidiary Cash Book for each call in the manner already described in the case of application and allotment moneys. In the financial books, a journal entry is made debiting the Call Account and crediting Share Capital Account with the total amount of the call. When the cash received has been posted to the credit of Call Account, the balance (if any) that remains will represent unpaid calls.

Moneys due under the terms of a prospectus are more frequently and properly termed "Instalments" as they are not actual calls made by the Directors.

The Directors' power to make calls is in the nature of a trust to be exercised for the benefit of the company. Calls must be made on all shareholders alike. No call can be made on some of the shareholders while others go free. A call can, of course, be made on one *class* of share and not on other classes. To create liability on the part of the shareholders, the call must be made by directors duly appointed, and qualified, at a meeting duly convened, a quorum being present, by a resolution duly passed, specifying the amount, and time and place of payment; though trifling irregularities will not invalidate the call. Calls date from the day the resolution is passed by the Directors making the call, but notice must be given to the shareholder.

Calls in Advance.—The Articles of most companies provide that calls paid in advance shall carry interest, usually at 4% p.a. Table A provides that the Directors may accept money in advance of calls and may pay thereon such interest (not exceeding 6 % p.a. without the sanction of a general meeting) as may be agreed upon between the members concerned and the Directors. Calls in advance may not be accepted merely to pay Directors' fees, they must be for the benefit of the company as a whole (*Sykes's* case, 1872). Calls so paid are really loans, and interest is payable on them even if no profits are made. Calls paid in advance do not carry any dividend rights as they do not form part of the company's called-up capital, unless, of course, the Articles provide otherwise. Table A, Art. 92, infers that if no interest is paid on calls in advance they will rank for dividend. In the event of liquidation calls in advance are repayable before payment is made on the amounts called up on the shares, but no refund of such moneys may be made while the company remains a going concern.

Calls in Arrear.—As a general rule, the Articles provide that members in arrear with their calls are not entitled to vote, and are liable after due notice to be charged with interest at a fixed rate. Table A provides for 5 % p.a. from the day appointed for payment to the time of actual payment, but gives the Directors power to waive the interest wholly or in part.

Share Certificates.—When the shares issued have been fully paid, or, if partly paid, when there is no immediate intention of calling up the balance remaining on them, share certificates are issued to members. Share certificates must, in any case, be completed and ready for delivery within two months of allotment or transfer unless the conditions under which the shares were issued otherwise provide (S. 67). They are issued under the common seal of the company, and are *prima-facie* evidence that the person named in them is the owner of the number of shares specified. Usually, they are signed by two Directors and the secretary. Prior to the issue of the certificates, a notice is sent to members that the certificates will be handed or posted to them in exchange for the allotment letters and bankers' receipts for the instalments paid on the shares, or, in the case of some transfers, in exchange for the balance ticket. The allotment letters, or balance tickets, are then cancelled and filed in order. A specimen share certificate is given on p. 296.

Share Certificate Book.—This book consists of pages divided by perforation into three parts: the first counterfoil records details of the number and date of the certificate, the name and address of the shareholder; the number of shares and their distinctive numbers. The second counterfoil is a form of acknowledgment, to be signed by the shareholder, of the receipt of the certificate. The third part is the certificate itself. The receipt counterfoil and the certificate are sent to the shareholder who signs and returns the receipt, which is then attached to the relative first counterfoil.

(*Share Certificate.*)

No. 362. *100* SHARES.

RAYON D'OR, LIMITED.

(*Incorporated under the Companies Act, 1929.*)

CAPITAL £100,000 : 0 : 0, in 100,000 SHARES OF £1 EACH.

This is to Certify that *Lionel Robert Clare*, of *The Beeches, Maidenhead*, is the Registered Proprietor of *100* Shares of £1 each, FULLY PAID, numbered *1* to *100* inclusive, in RAYON D'OR, LIMITED, pursuant to the Memorandum and Articles of Association of the said Company.

SEAL

Given under the Common Seal of the Company this 25th day of *March*, 19...

John Straight
George Dickson } Directors

Philip Roberts, Secretary.

NOTE.—No Transfer of any of the Shares comprised in this Certificate will be registered until the Certificate has been delivered at the Company's Office.

Share Warrants.—If sanctioned by the Articles, share warrants to bearer, under seal of the company, may be issued in exchange for fully paid share certificates (S. 70). And the holder of a share warrant may return it to the company for cancellation and be entered in the Register as a member holding the shares specified in the warrant (S. 97). Share warrants are negotiable instruments, and can be transferred by simple delivery, no transfer in the company's books being necessary. Private companies cannot issue share warrants, since such companies must restrict the transfer of their shares. On exchange of share certificates for share warrants, the members are struck off the register. But, if the Articles so provide, the holder of a warrant may be deemed to be a member of the company either to the full extent or for any purposes defined in the Articles, except that he cannot act as a Director or Manager of the company in cases where the Articles impose a share qualification. Share warrants are impressed with a stamp representing three times the *ad valorem* transfer duty payable on the nominal value of the shares represented by the warrant. Payment of dividends on share warrants may be provided, and usually is provided, by means of coupons attached to the warrant. Share warrants are popular on the Continent, but are not extensively used in this country.

Provision of Financial Assistance by Company for Purchase of its own Shares.—It is illegal for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision

of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase of shares in the company, unless the money is lent in the ordinary course of the business of a money-lending company, or in connection with a trust under a scheme for the benefit of employees, or to employees other than directors to enable them to acquire fully paid shares (S. 45).

Capital of a Company.—It will be useful at this point to deal with the terms descriptive of a company's capital, and the various classes into which it may be divided.

Authorised (*Nominal or Registered*) *Capital.*—This is the maximum amount of capital which a company takes power in its Memorandum to issue (S. 2 [4]). A statement of this capital, made on the statutory form, must be registered with the Registrar and, in addition to registration fees, capital duty must be paid thereon at the rate of £1 % (*Finance Act*, 1920). The authorised capital may or may not be wholly issued ; the issued capital may or may not be wholly subscribed ; the subscribed capital may or may not be wholly called up ; and the called-up capital may or may not be wholly paid up. The authorised capital is divided into shares, the denominational value of which is decided by the promoters of the company. Shares of £1 each are the most common, but denominations varying from 6d. to £100 may be met with ; indeed there are instances of companies being registered with a nominal capital of £1 divided into shares of ¼d. each ! If shares are issued at too high a nominal value, it usually results in a restricted market for the shares. The same company may issue shares of different classes and different denominational values, as provided for in its Memorandum or Articles. The nominal capital may be increased or decreased in accordance with the provisions of the Act of 1929, S. 50 (*see* p. 270). It is the practice to state the nominal capital in the Balance Sheet "short." It does not appear in the company's financial books until it is issued and subscribed.*

Issued Capital.—This is that portion of a company's authorised capital which has been issued to the public for subscription, or to the vendors as fully or partly paid in exchange for assets acquired by the company. But all the capital issued for public subscription may not be taken up by the public.

Subscribed Capital.—This consists of that portion of the issued capital which is actually subscribed for by the public, or allotted to vendors in respect of assets conveyed to the company. Very frequently

* In Scotland and certain foreign countries, an *Uncalled Capital Account* is opened for that part of the Issued Capital which has not been called, in which case the full nominal value of the Issued Capital is entered in the latter account. Certain companies also open up *Unissued Capital Accounts*, showing the full Nominal Capital in an account so called. These practices are not common in this country.

the subscribed capital is less than the authorised capital, because the whole authorised capital has not been issued for subscription, or has not been subscribed for by the public. The student will realise that the distinction between "Issued" and "Subscribed" capital is more academic than practical, in view of the fact that only the capital actually subscribed can be shown on the Balance Sheet.

Called-up Capital.—The called-up capital is that part of the subscribed capital which has actually been called up. The uncalled part of the subscribed capital, which represents the contingent liability of the shareholders on the shares, is known as the *Uncalled Capital.*

Paid-up Capital.—The paid-up capital is that part of the subscribed capital which has been called up and actually paid by the subscribers. The paid-up capital may be somewhat less than the called-up capital by reason of the failure of subscribers to pay the calls on shares for which they have subscribed. The difference between the called-up and the paid-up capital represents calls in arrear.

Reserve Liability.—By S. 49, a limited company may, by special resolution, determine that any portion of its share capital not already called up shall not be capable of being called up except in the event and for the purposes of liquidation. This method of providing a reserve, and so increasing a company's stability, has been adopted by some banks.

Working Capital.—Working capital is the amount by which the readily realisable, liquid, or "quick" assets of a concern exceed its current liabilities. Thus, the total of a company's cash, investments, bills receivable, stock, book debts, and similar liquid assets *minus* its trade creditors, bank overdraft, bills payable and similar floating liabilities represents the working capital of the company. In calculating such capital, the fixed, and more or less permanent assets, such as buildings, plant, etc., and long or fixed period loans and similar "fixed" liabilities, are excluded. The term "working capital" is sometimes loosely employed to indicate: (*a*) the balance left after paying the purchase price of a business; (*b*) the floating assets; (*c*) debentures issued to raise money to work the business; or, (*d*) under the double-account system, the excess of capital receipts over capital expenditure. In all these cases the use of the term is inexact and unfortunate.

Loan Capital.—This is a term sometimes applied to debentures and other loans for fixed terms. The employment of the term is not happy, since these loans do not form part of a company's capital, and the regulations as to share capital contained in the Act of 1929 do not apply to them. They are liabilities, and the lenders are creditors, having no part or parcel in the company's affairs unless the instrument acknowledging the loan so provides, e.g. if the company makes default. The student should carefully note these distinctions.

Illustration.—Uprichards, Ltd., was registered with a nominal capital of £100,000, divided into 100,000 shares of £1 each. Of this amount 75,000 shares were offered to the public and fully subscribed. By December 31, 19.., 15s. per share had been called up and paid up, except that the last call of 5s. per share on 1,000 shares remained unpaid. Give the entries necessary to record these particulars in the Company's Balance Sheet.

BALANCE SHEET.

LIABILITIES SIDE ONLY.

	£	£
Capital—		
Nominal :—100,000 shares of £1 each	£100,000	
Issued :—75,000 shares of £1 each, 15s. per share called up	56,250	
Less Unpaid calls	250	
		£56,000

In this example, therefore :—

		£
The Authorised (Nominal or Registered) Capital	=	100,000
The Issued Capital	=	75,000
The Subscribed Capital	=	75,000
The Called-up Capital	=	56,250
The Paid-up Capital	=	56,000
The Uncalled Capital	=	18,750
The Calls in arrear	=	250

Classes of Shares.—Various classes of shares are commonly met with. These comprise (1) Preference Shares divided into (*a*) Simple or non-cumulative preference shares, (*b*) Cumulative preference shares, (*c*) Participating preference shares, (*d*) Pre-preference, or first preference shares, (*e*) Convertible preference shares, (*f*) Preferred Ordinary Shares; (2) Redeemable Preference Shares; (3) Ordinary Shares; (4) Deferred Ordinary Shares; (5) Deferred, Management, or Founders Shares; (6) Bonus Shares.

Preference Shares.—These usually rank first both as to payment of dividend and return of capital. Preference shares may be issued carrying the first of these preferences only, but if they carry both, then (*a*) the fixed rate of interest attached to the shares must be paid out of profits before the ordinary shares rank for dividend; (*b*) in the event of the company going into liquidation, preference capital has the right to prior payment before other classes of shares, should funds for repayment be available after payment of debts.

It would appear that a limited company has power to issue preference shares even when the Memorandum is silent on the point.

In the absence of provision to the contrary in the Memorandum or terms of issue, any surplus remaining after all share capital has been repaid must be divided amongst all shareholders (*Anglo-French Music Co.* v. *Nicol*, [1921]). But where the rights of preference shareholders are precisely set out in the Memorandum, this may bar their right to share in such surplus (*Collaroy Co.* v. *Giffard* [1928]).

Simple or Non-Cumulative Preference Shares.—These are preference shares, which carry a preferential right to dividend out of the profits of each year only, that is so far as profits are available to pay the dividend. The decision as to what profits are available rests with the directors. These shares have no claim on the profits of succeeding years should the profits for any year be inadequate to pay the dividend. Care should be taken to make it clear that the shares are non-cumulative, otherwise subscribers are entitled to assume that they are cumulative.

Cumulative Preference Shares.—With this class of share, the preferential rights to dividend accumulate from year to year in the event of the non-payment of dividend, the arrears of one year being carried forward to the next, and so on. Thus, if a company issued 6 % cumulative preference shares, and made insufficient profits to pay the dividend upon them for four years, it would have accumulated a liability to pay four years' dividend at 6 % p.a., as and when sufficient profits were available to meet these claims, before any dividend could be paid to the holders of subordinate classes of shares. In cases of this sort, a note should be made on the face of the Balance Sheet to the effect that *No dividend has been paid on the Preference Share capital of the Company for any of the four years now ended.* Since the liability is contingent upon sufficient profits being earned to meet it, and on dividends being declared, no entries can be made in the books of the company.

If the Articles are silent on the point, preference shares are assumed to be cumulative.

Under Table A, unless special rights are attached to the shares, all dividends are payable only on the amounts actually paid up on the shares, but under some Articles, and in all cases where Table A is barred, and the special Articles make no provision, dividends are payable on the nominal amount of the shares* (*Oakbank Oil Co.* v. *Crum*, [1883]). Preference shares do not carry preferential rights as to capital repayment unless this right is expressly stated in the conditions of issue, and in the Memorandum and Articles.

Participating Preference Shares.—In addition to the advantages attaching to cumulative preference shares, these shares carry a right to a fixed share in the surplus profits after payment of the fixed dividend to which they are entitled, usually after a certain minimum has been paid on the subordinate classes of shares.

Pre-preference (or First Preference) Shares.—For the purpose of raising urgently needed capital, these shares are sometimes issued with the consent of the preference shareholders. As the name implies, the terms of issue (which must be *intra vires* the Memorandum and Articles) provide that the rights of the holders of such shares in respect of dividend and capital repayment stand in front of the rights of the holders of all other classes of shares.

Convertible Preference Shares.—These are preference shares the

* This applies to all dividends—preference or otherwise.

holders of which have the right to have them converted into another class of share, e.g. ordinary or deferred, within a specified time.

Preferred Ordinary Shares.—Holders of these shares have the right to a fixed dividend after the claims of the preference shareholders have been met, and before the ordinary shares rank for dividend.

Redeemable Preference Shares.—A company limited by shares may, if so authorised by its Articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed. No such shares may be redeemed except out of the profits of the company which would otherwise be available for dividend, or out of the proceeds of a fresh issue of shares made for the purpose of the redemption. Such shares can be redeemed only when fully paid. When they are redeemed otherwise than out of the proceeds of a fresh issue, there must be set aside, out of profits which would otherwise be available for dividend, a sum equal to the amount applied in redeeming the shares, to a reserve fund called "the *Capital Redemption Reserve Fund.*" The provisions of the Act as to reduction of share capital apply to such a fund as if it were share capital. If the shares are redeemed out of the proceeds of a fresh issue, any premium payable on redemption must have been provided for out of profits (S. 46 [1]).

Every Balance Sheet must specify what part of the issued capital consists of redeemable preference shares and the date on or before which these shares are, or are liable, to be redeemed (S. 46 [2]).

If a company has redeemed or is about to redeem any preference shares, it may issue shares up to the nominal amount of the shares redeemed or to be redeemed as if those shares had never been issued, and no stamp duty is payable on such amount provided the old shares are redeemed within one month after the issue of the new shares (S. 46 [4]). The capital redemption reserve fund may then be applied (up to the nominal amount of the shares so issued) in paying up unissued shares of the company to be issued to members as fully paid bonus shares.

For example see p. 385.

Ordinary Shares.—The bulk of the shares issued by most limited companies are of this class. Ordinary shares carry no special rights as to dividend or capital repayment. Generally, they are entitled to the surplus profits remaining after the prior fixed dividends, enumerated above, have been satisfied. But they may be subject to the rights attaching to deferred ordinary shares, if such exist.

Deferred, Management, and Founders Shares.—These shares are usually issued as fully paid to the promoters, or managers, of the issuing company. As regards dividend, they usually stand aside until an agreed dividend has been paid on the ordinary shares. Particulars of founders, or deferred, shares must be stated in the Prospectus (Fourth Schedule, Part I, 2). Though generally few in number and insignificant in nominal value, the voting powers which they command

and the profits they share are often considerable. They are not popular with the investing public, since they do not always tend to prudent management, the holders being usually desirous of dividing all available profits without much regard for the prudent building up of reserves. The issue of these shares is, however, probably the most scientific method of paying for goodwill, since the value of this asset largely depends upon the profits earned being in excess of a certain minimum. But where such shares are issued in payment for the goodwill, an equitable number of similar shares should be issued to the shareholders of other classes who run the real risk of the business.

Bonus Shares.—Successful companies sometimes issue shares in lieu of increased dividends. The usual procedure is to declare a dividend, credit the shareholders with the dividend, and then to issue shares in discharge thereof, no money passing on either side (*see* p. 372). Bonus shares may be of any of the classes described above. The provisions regarding the issue of bonus shares where redeemable preference shares have been redeemed should also be referred to at p. 301.

Co-Partnership Shares.—These shares are sometimes issued to a company's employees in order to give them an interest in the concern. Frequently, such shares carry no voting power. They are usually entitled to the same dividend rights as the ordinary shares, but their transfer is usually under the control of the company, and effected at a fixed price. Sometimes *Profit-Sharing Certificates* are issued to employees. These have no capital value, but entitle the holders to dividends upon an assumed capital value stated on the face of the certificate. Such certificates cannot be sold, and must be surrendered to the company on demand.

EXAMINATION QUESTION.

What is the difference between a "Cumulative" and a "Non-Cumulative" Preference Share? Does this difference affect the annual accounts in any manner? (*London Chamber Commerce.*)

Answer.

Cumulative Preference Shares are shares which carry preferential rights to dividend, usually ranking before all other classes of shares. In addition, in the event of the available profits in any year proving insufficient to meet the fixed preference dividend, the arrears *accumulate*, and no dividend can be paid on shares having subordinate rights until these arrears have been discharged. No obligation, however, exists to pay the cumulative preference dividends, unless sufficient profits are available to discharge them, *and dividends are declared*. The Memorandum and Articles and the terms of issue usually provide that, in the event of liquidation, after the costs of the liquidation have been met, and the secured and unsecured creditors have been satisfied, the surplus assets shall be applied first in paying off any arrears of cumulative preference dividend, then in repaying the preference share capital.

Non-Cumulative (or Simple) Preference Shares possess no right to the accumulation of dividends, and in the event of dividends being passed,

or only partially satisfied, the holders of these shares have no claim upon the profits of subsequent years for arrears of dividend. Each year stands alone. These shares usually have a right to repayment of capital in priority to holders of other classes of shares, subject, of course, to the rights of the holders of any shares of a higher class which may have been issued.

Preference shares are cumulative unless it is clearly otherwise stated in the Memorandum, or, if the Memorandum is silent, in the Articles or in the Terms of Issue.

Treatment in the Annual Accounts.—In the case of cumulative preference shares, a note of dividends thereon which have been passed should be made on the face of the Balance Sheet if any arrears of dividend exist, otherwise the holders and prospective holders of shares of this and subordinate classes of shares may be prejudiced. No such note is required in the case of non-cumulative shares, as dividends which have been passed are not payable out of subsequent distributions of profit.

Issue of Shares at a Discount.—A company can issue at a discount shares of a class already issued, in certain circumscribed circumstances, viz.:

(*a*) The issue must be authorized by resolution passed in general meeting of the company and sanctioned by the court;

(*b*) The resolution must specify the maximum rate of discount;

(*c*) Not less than one year must have elapsed since the date on which the company was entitled to commence business;

(*d*) The shares must be issued within one month after the date on which the issue was sanctioned by the court, or such extended time as the court may allow.

The court may make terms and conditions when sanctioning the issue. Particulars of the discount allowed, or of so much as has not been written off, must appear in every prospectus relating to the issue, and in every subsequent Balance Sheet (S. 47) (see p. 352).

Stock.—If the Articles confer the necessary authority, companies may convert their fully paid shares into stock, or reconvert that stock into paid-up shares of any denomination (S. 50, ss. 1 (*c*)). These powers are not often exercised. The differences between shares and stock may be described as follows:—

In the case of shares, the capital is divided into so many equal parts, e.g. £1, and each £1 share bears a distinctive number.

Illustration.—Dicksons, Ltd., was registered with a capital of £50,000, divided into 50,000 ordinary shares of £1 each, numbered 1 to 50,000.

Shares cannot be issued at a discount, i.e. below their nominal value, except under the provisions of S. 47 (see above), and they can only be transferred in their entirety, i.e. not less than one share can be transferred. But, subject to the Memorandum and Articles, and the terms of issue, they can be transferred at any time after allotment, whether fully paid up or not.

In the case of stock, the capital may be said to be consolidated into one mass, or block, and may be transferred in units of a fixed amount,

e.g. £5 or multiples thereof, or even in fractions of a pound. The stock of commercial companies is usually transferable in definite units, e.g. £1, £5, etc., but most Government stocks are transferable in fractional amounts, e.g. £101 9s. 2d. Transfers of stock are effected in the same manner as transfers of shares, i.e. under seal on the common transfer form.

Illustration.—Uprichards, Ltd., was registered with a capital of £100,000, divided into 50,000 6 % preference shares of £1 each, and 50,000 ordinary shares of £1 each. The latter, when fully paid, were converted into stock. Subject to the Articles, this stock can be transferred in any fractions, e.g. £109 12s. 6d.

Stock cannot, of course, bear distinctive numbers, and it is equally obvious that it must be fully paid up. In other respects both shares and stock possess the same characteristics. Dividend rights, priority of capital repayment, and so on, may be identical in both cases. The British Government debt, and most municipal and colonial loans, in addition to many commercial issues, are in the form of stock. In the case of statutory and similar companies, stock may be issued at a discount in many cases. It will, however, be obvious that stock cannot be so issued by companies working under the Act of 1929, since shares must be fully paid before they can be converted into stock.

Kinds of stock.—Just as there are several classes of shares so there are several classes of stock. *Preferred Stock* is a term which is self-explanatory. *Guaranteed Stock* is stock that is guaranteed both as to capital and dividend by some Government or outside Corporation. *Deferred Stock* is stock the dividends on which are deferred in favour of prior classes of stock. *Inscribed Stock* is stock, the title to which consists in the names of the holders being " inscribed " in the books of the Bank of England or other bank or authority managing the stock, instead of being evidenced by certificates. British Government borrowings, e.g. War Loan (a portion of which is inscribed), are examples of inscribed stock.

The Bank of England rules regarding the transfer of Stocks are as follows:—

Stock can be transferred—

By the Stockholder, or in a joint account by all the Stockholders (or, if the Stockholder or Surviving Stockholder is deceased, by his Executors or Administrators), attending in person at the Bank of England, being identified by a Stockbroker and executing a transfer in the Bank books; or by a duly authorized Attorney, in like manner.

War Stock (£4 %, £4½ % and £5 %), £4% Funding Stock, £3½ % and £4½% Conversion Stocks, Registered Treasury Bonds, £2½ % and £4 % Consolidated Stocks, £2½ % Annuities, £2¾ % Annuities, Local Loans £3 %, Guaranteed £2¾ % and £3 % Stocks, and Guaranteed Land Stock, 1921 (Irish Land Stocks), Indian Government Stocks, and Birkenhead £6 % Stock, if registered as Transferable by Deed

can be transferred by Deed by the Holder, or in a joint account by all the Holders (or, if the Holder or Surviving Holder is deceased, by his Executors or Administrators); or by a duly authorized Attorney. The Deed of Transfer duly completed must be lodged at the Bank with the corresponding Certificate.

N.B.—Holdings of these Stocks transferable in the Stock Transfer Books and not by Deed may be registered as transferable by Deed on demand made in the prescribed form (to be obtained at the Bank of England) by the Holder, or Holders (as above).

Holdings transferable by Deed may be made transferable in the Stock Transfer Books on demand made in like manner and on surrender of the Register Certificate.

In the case of Inscribed Stock and Bonds registered as transferable in the Bank books, production of Stock Receipts, Certificates of Inscription, or Certificates of Registration is not required when the Stock to which they relate is dealt with; these documents are of value only as memoranda, the title of the Stockholder being the entry in the Bank books. Duplicates of such documents are not issued.

The Register Certificate issued in respect of Stock transferable by Deed must, however, be surrendered when any part of the Stock to which it relates is dealt with.

A Stockholder can obtain verification of the inscription of the Stock to which a Stock receipt purports to relate, either by personal attendance at the Bank bringing with him the Stock receipt and being accompanied by a Stockbroker for purposes of identification; or, by forwarding the Stock receipt with a request, bearing his signature, for confirmation, and a postal order for 1*s.* (except in the case of British and Indian Government Securities, where no fee is payable) to the Chief Accountant, Bank of England, E.C. 2. In the latter case the receipt will be returned enfaced with a statement as to the inscription of the Stock.

Borrowing Powers of a Company.—Even successful companies are sometimes in need of cash. Temporary shortage of working capital, heavy purchases of stock or raw material to take advantage of a favourable market, the need for granting extra credit to tide over a period of trade depression, these and other circumstances may create the necessity to borrow. Trading companies have an implied power to borrow, if such borrowing is properly incidental to the conduct of the business (*General Auction Estate Co.* v. *Smith*, [1891]), and to pledge their assets as security (*Re Patent File Co.*, [1871]), even when no powers are taken so to do in the Memorandum. There are no statutory limits to a trading company's borrowing powers, but they are usually defined in the Memorandum or Articles, and are frequently limited to an amount not exceeding the issued capital of the company. Non-trading companies have no power to borrow or to pledge their assets, in the absence of express power so to do in the Memorandum. If a Stock Exchange quotation is sought, the articles must fix a reasonable limitation to borrowing powers, any extension thereof being subject to control by the company in general meeting.

Debentures.—Companies frequently raise money by means of loans for fixed periods, repayment of which is generally secured to the lender by some charge on the company's assets. Loans are frequently evidenced by documents termed *Debentures.* It has already been stated that these loans do not form part of a company's capital, as is sometimes erroneously supposed. A shareholder is a *proprietor* or *partner* in the company; a debenture holder or other lender is a *creditor* of the company, and the interest on the loan accrued due to him is payable whether the company makes profits or not. A debenture holder of a public company is, by S. 130, entitled to be furnished on demand, without charge, with a copy of the last Balance Sheet, but he is not a member of the company.

Definition of Debenture.—There is no precise statutory definition of a debenture, but it may be defined as "a document issued, usually under seal, by a company to a creditor in respect of money lent by him to the company, to secure the payment of interest at the rate and on the sum specified therein, and repayment of the capital." There is no statutory form of debenture, but a form in common use is shown on p. 308.

Nature of Debenture Charge.—A debenture may create a specific charge on some particular asset of a company, e.g. its freehold factory. In that case the debenture is said to create a *Fixed Charge* on the particular property. The modern debenture usually covers the whole of the property of the company "whatsoever and wheresoever both present and future including its uncalled capital." A charge of this kind covers all the company's assets, including those which fluctuate in value from day to day, such as book debts and stock, and is called a *Floating Charge*. It does not prevent the company from dealing with such assets in the ordinary course of business, but it creates a charge upon them as against other creditors. All debenture issues secured by any charge must be registered with the Registrar of Joint Stock Companies.

Kinds of Debentures.—Various kinds of debentures are to be met with in practice. *First Mortgage Debentures; Second Mortgage Debentures*, as the names indicate, rank in the order of issue. The holders of the first issue must be satisfied in priority to the holders of the second, and so on. *Registered Debentures* are debentures which are registered in the books of the company, and, therefore, capable of transfer in a similar way to shares. *Bearer Debentures*, on the other hand, are negotiable instruments capable of transfer by mere delivery. In this country, the majority of debentures are registered, but in other countries bearer debentures are almost exclusively employed. *Naked* or *Simple Debentures* afford no charge on the property of the issuers, and the holders of such debentures are therefore unsecured creditors. They are uncommon except as acknowledgments of loans for short periods. *Irredeemable (Perpetual) Debentures* are debentures the

capital sum secured by which is not repayable except in the event of the company ceasing to exist. They are really perpetual annuities. *Debenture Stock* represents debentures consolidated into one stock, or " one mass for the sake of convenience " (Lord Lindley), just as fully paid shares may be consolidated into stock. Debenture stock must be fully paid, and may be transferred in agreed fractions. Almost invariably, debenture stock is covered by a charge on the assets.

Issue of Debentures.—Debentures may be issued at par, or at a discount, or at a premium. Shares may be issued at par or at a premium, but may be issued at a discount only under S. 47 (see p. 303) and not otherwise. Debentures must not be issued at a discount if there is power to exchange them before the maturity of the debentures for fully paid shares other than those issued at a similar or less discount under S. 47, for that would be a method of illegally attempting to issue shares at a discount. There is, however, nothing to prevent, e.g., the conversion of a £100 debenture issued at 95 into 95 £1 Preference Shares or into 100 Preference Shares of £1 with 19s. paid up, or into Shares issuable under S. 47 at a discount of not less than 5 per cent.

Form of Debentures.—In this country, debentures are usually registered, and recorded in the Register of Debenture Holders in a similar way to the record of shares in the Share Registers. Certificates [or bonds] are issued in respect of them. Debentures are transferable in common form by deed. Where bearer bonds are issued they have interest coupons attached, and are transferable by delivery alone.

Interest on Debentures.—Debenture interest is payable quarterly, half-yearly, or yearly, half-yearly payments being the most usual. Cheques (or warrants) are posted to the holders of registered bonds for the interest due, less tax at the current rate. Bearer debentures carry a perforated sheet of detachable *coupons* covering each payment of interest due over a number of years. These are detached on the due dates and paid in, like cheques, to bankers for collection. If the sheet of coupons does not cover the " life " of the debenture, a slip, called a *Talon*, is attached as a voucher entitling the holder to a fresh sheet of coupons. When the coupons have been paid by the company, they are usually pasted into albums, similar to stamp albums, representing each dividend paid.

Trust Deed.—The security supporting a debenture issue, and the terms of issue, are usually set forth in a document called a *Trust Deed*, by which the company's properties are charged in favour of certain nominees, termed *Debenture Trustees*. These trustees represent the debenture holders and safeguard their interests. Sometimes a deed is dispensed with, and the debentures themselves contain the charge. But such a deed is essential in the case of debenture stock. Debenture holders may demand a copy of the trust deed, if printed, on payment of one shilling ; if not printed, they may demand a copy upon payment at the rate of 6d. per 100 words.

The following is a form of debenture such as is used when there is no trust deed :—

UPRICHARDS, LIMITED.

Issue of [100] Mortgage Debentures of £[100] each numbered 1 to 100 bearing interest at £5 per cent. per annum payable on the first day of January and the first day of July in each year.

The issue is made pursuant to Clause 15 of the Company's Memorandum of Association and Article 36 of the Company's Articles of Association and a resolution of the directors passed on the fifteenth day of December, 19...

DEBENTURE.

No. 52. £[100]

1. Uprichards, Limited, whose registered office is at 532 Oxford Street, London, W. (hereinafter called the Company), will, on the first day of January, 19.., or on such earlier day as the principal moneys hereby secured become payable under the conditions of this debenture, pay to *Miles Further*, of *Maidenhead*, *Berks*., or other the registered holder hereof (hereinafter called the debenture holder, which expression shall, where the context so admits, include his personal representatives), the sum of £[100].

2. The Company will until payment of the said sum of £[100] pay to the debenture holder interest thereon at the rate of £5 per cent. per annum, by equal half-yearly payments on the first day of January and the first day of July in each year, the first payment to be made on the first day of July next [and to be calculated from the date hereof].

3. The Company hereby charges with the said payments its undertaking and all its property present and future, including uncalled capital and goodwill.

4. This debenture is issued subject to and with the benefit of the conditions indorsed hereon, which are to be deemed part of it.

Given under the seal of the Company this 31st day of December, 19...
The common seal of the above-named Company was affixed hereto in the presence of

HUGH DICKSON } *Directors*.
GEORGE DICKSON }
ABEL CHATENAY, *Secretary*.

[NOTE.—On the back, or following pages, are printed the conditions *see* below).]

Conditions of Issue.—These usually contain provisions to the effect following :—

(1) The debenture is to be one of a series securing, say, £10,000 in all, and all the debentures of the series are to rank *pari passu* as a first charge on the property and assets of the company without any preference or priority over one another.

(2) The charge to constitute a floating security on all the property of the company, but sometimes power is reserved for the company to mortgage specific assets, and on the purchase of any additional property to mortgage it to secure the whole or part of the purchase money ; and so long as the charge is a floating charge (i.e. until the debentures become payable) the company may carry on its business and deal with its property as the company may think fit.

(3) There are provisions for a register of debentures, for transfers being in writing and delivered to and retained by the company; for the executor or administrator of a deceased debenture holder being the only persons recognised by the company as having any title to it; for a fee of 2s. 6d. to be paid for registration of any transfer or probate; and the company is to be entitled to treat the debenture holder as the sole and absolute owner, and no notice of any trust is to be entered on the register.

(4) Provisions are sometimes made that interest will be paid by cheques posted to debenture holders.

(5) There is the important clause dealing with the events on which the principal moneys become payable. These are usually the following:—

(*a*) If the company gives three months' notice of intention to pay off.

(*b*) If the company makes default for a stipulated period, such as fourteen days, in payment of interest, though it is usual to add the proviso that notice must be given requiring payment of the principal moneys before the interest is actually paid.

(*c*) If a distress or execution be levied or issued against the company.

(*d*) If an order is made for winding up or a resolution passed to the same effect.

(6) Debenture holders are often given power to appoint a Receiver after the principal moneys have become payable. Such an appointment may be made as the condition is framed, either by all the debenture holders concurring or by the majority in value of the debenture holders. The person appointed Receiver may also be appointed Manager, and may have power to take possession of the property charged, carry on the business of the company, sell the security, and make any arrangement or compromise.

(7) There is usually a clause providing that the proceeds of sale be applied:—

(*a*) In payment of the expenses of and incidental to the appointment of the Receiver and the exercise of his powers and his remuneration.

(*b*) In payment to the debenture holders *pari passu* of all principal moneys.

(*c*) In payment of arrears of interest.

(*d*) Any surplus to be paid to the company.

(8) Sometimes a clause is added saying that the rights of the debenture holders may be varied with the consent of the holders of three-fourths of the debentures for the time being outstanding,

the decision of that majority to be binding on the debenture holders. The rights of the debenture holders are subject to those of creditors whose claims are declared by S. 264 to be preferential in a winding up (S. 78).

Where there is a large issue of debentures it is usual to have a trust deed. The provisions are similar in general effect to those given above. Specific property is often mortgaged to the trustees for debenture holders with or without a floating charge on other assets, and the powers of realisation and so forth are exercisable by the trustees.

Receiver Appointed by the Court.—Notwithstanding the existence of powers to appoint a Receiver without going to the Court it is often advisable to apply to the Court, and it is necessary to do so where the ground of application is that the assets are in jeopardy (although there has not yet been any default by the company), for it is not usual for debenture holders to have power to appoint in such a case, which obviously is likely to give rise to differences of opinion.

There is also the advantage that a Receiver appointed by the Court is an agent of the Court, and interference with him amounts to contempt of court. If he enters into contracts in carrying on the business or for the purpose of realisation he is personally liable upon them, though with a right to be indemnified out of the assets.

Receiver Appointed by Debenture Holders.—A Receiver appointed by the debenture holders under the powers contained in the debentures is their agent, and they are liable upon his contracts. To avoid this it is usual to provide in the conditions that the Receiver when appointed shall be the agent of the company (in which case the company is liable on his contracts) and to embody the powers given to mortgagees by the *Law of Property Act*, 1925, and formerly by the *Conveyancing Act*, 1881. But even if the Receiver is made an agent for the company his powers to bind it cease when the company is ordered to be wound up, though he does not thereby become agent for the debenture holders. He should, therefore, for his protection obtain an indemnity from the persons appointing him before incurring serious liability, unless the assets are certainly sufficient to recoup him.

Registration of Debentures.—The requirement, stated below, that every mortgage by a company shall be registered applies to debentures. Every mortgage or charge (*a*) to secure debentures, (*b*) on uncalled capital, (*c*) which if given by an individual would require registration as a bill of sale, (*d*) on land, (*e*) on book debts, or (*f*) floating charge, (*g*) on calls made but not paid, (*h*) on a ship or any share in a ship, or (*i*) on goodwill, on a patent, or a licence under a patent, or on a copyright, or a licence under a copyright, is void unless registered within twenty-one days. The Court has power to allow subsequent registration, if the omission to register was due to accident or inadvertence, on such terms as it thinks fit.

The register (which is in fact a part of the file of the company's papers at Somerset House) is open to inspection, so that persons dealing with a company may be able to ascertain whether it has mortgaged its assets.

A floating charge created within six months of the commencement of the winding up is void unless the company immediately after the creation of the charge was solvent, except to the amount of any cash paid to the company at the time of, or subsequently to the creation of, and in consideration for, the charge, together with interest at 5 % (S. 266).

Rights of Debenture Holders.—A debenture holder is entitled to have a copy of the trust deed by which they are secured and to inspect the register of debenture holders (S. 73) and to obtain the balance sheets of the company and the reports of the auditors (S. 130). He has also, when the principal money secured has become due, the ordinary rights of a creditor. He may sue for his debt, recover judgment and issue execution, or petition for the winding up of the company. But as he is a secured creditor he is more likely to realise his security, which he does by the appointment of a receiver.

As soon as the principal moneys become payable and the debenture holders intervene, the "floating charge" is said to become fixed, or to attach. Until then the company can deal with its property; but the charge then attaches to all assets which have not been alienated.

Redemption of Debentures.—As stated above, some debentures, termed Irredeemable, are payable only in the event of liquidation. Other methods of repayment are: (*a*) *By Drawings* determined by ballot, the numbers drawn in the case of bearer bonds being advertised in the Press. (*b*) *On Demand*, a term that explains itself. (*c*) *At a Fixed Date*, i.e. at the date specified in the terms of issue. A company usually has power to anticipate this date. (*d*) *At the Option of the Company*, i.e. at any time fixed by the company, subject to due notice being given to the holders. (*e*) By *Purchase in Open Market*, provided that the company has reserved this power to itself. (*f*) By the *Issue of New Debentures*, the proceeds of which are used to pay off the old debentures.

Except when new debentures are issued to replace old, the necessary funds for the redemption of debentures may be provided out of capital, or profits, or from a fund accumulated for the purpose by outside investment, or from the proceeds of a capital endowment policy.

Re-issue of Debentures.—By S. 75, debentures that have been redeemed may be re-issued unless any provision to the contrary, express or implied, is contained in the articles or in any contract entered into by the company, or the company has, by passing a resolution, or some other act, manifested its intention that the debentures shall be cancelled. Debentures so re-issued must be stamped as new debentures. But debentures deposited with a banker to secure

advances on current account are not deemed to have been redeemed by reason only of the current account having ceased to be in debit while the debentures are so deposited. That is to say, the debentures are available without fresh stamping to secure future advances.

Notes.—A practice has arisen within recent years, and appears likely to spread, among limited companies of issuing "notes" in acknowledgment of moneys lent. These notes are issued under the seal of the company. They give no specific charge on the company's assets, and are usually repayable at definite dates, or by means of periodical drawings. The wording of the note will probably decide whether it comes within the category of a promissory note or a naked debenture —no legal guidance is yet available on the point. The holders of such notes are probably unsecured creditors. The amount outstanding under this heading should be separately stated in the Balance Sheet immediately after the item "Debentures," if any have been issued.

Example of Capital Issue.—The student is sometimes puzzled when confronted by the array of debentures and shares of various classes offered for subscription by some companies, and wonders why the simpler course of confining the capital issue to ordinary shares is not followed. The answer is that financial expediency, and not simplicity, is the governing factor.

Illustration.—Rayon d'Or, Ltd., is registered to purchase an old-established business. The purchase price of the assets and goodwill is £250,000. It is decided that £50,000 is required for working capital. The capital is therefore fixed at £300,000. The profits of the business for the past five years averaged £24,000. This figure shows 8 % on the proposed capital, a not sufficiently attractive return on an undertaking of this class. There is also to be considered the investor who prefers a lower rate of return, provided that it is combined with the greater capital security that is offered by debentures or preference shares. To meet the needs of all classes of investors, the following issues are decided upon :—

	Issue.	Interest Required.
£		£
100,000	5 % Debentures	5,000
100,000	7 % Cumulative Preference Shares ..	7,000
	Leaving for dividend on	
100,000	Ordinary Shares at, say, 12 %	12,000
£300,000		£24,000

Stock Exchange Quotation.—Most large public companies desire to have an *Official Quotation* on the London Stock Exchange for their shares and debentures. To obtain this quotation certain rules and formalities must be observed. These are too lengthy to set out here, but they have been dealt with in sufficient detail in the author's *Accounting*. Without an official quotation, the market for any particular stocks or shares is very restricted, and in a restricted market prices suffer. If the application for a quotation is successful, the company's

shares will in due course be quoted in the Stock Exchange List, published daily, at the prices ruling at 3.30 p.m. on the day of publication; and similar information will appear in the financial columns of the Press.

EXAMINATION QUESTIONS.

1. Define the several kinds of companies which may be incorporated under the Companies Act, 1929. For what purposes, to what extent, and how may a company change (*a*) its name, (*b*) its objects, (*c*) its Articles of Association?

2. In what events may the liability of a shareholder in a limited company become unlimited?

3. State briefly the main distinctions between a company limited by shares and a partnership.

4. What do you understand by a Statutory or Parliamentary company? State briefly wherein they differ from companies incorporated under the Act of 1929.

5. Describe the steps necessary for the actual formation of a new company. (*Royal Society Arts.*)

6. Briefly describe the differences which exist between a public and a private limited company. (*Royal Society Arts.*)

7. What is meant by a "private company" under the Companies Act, 1929? Mention some of the privileges and immunities conceded to such a company, and state how it may turn itself into a public company.

8. What limit is placed on the number of members of a private company? How is the private character of a company terminated? (*Central Association Accountants.*)

9. What are the contents and functions of the Memorandum of Association of a company? (*Chartered Accountants.*)

10. Define the Memorandum? How far may it be altered or extended? (*Royal Society Arts.*)

11. How, and to what extent, may the objects clause in the Memorandum be altered? (*Chartered Institute Secretaries.*)

12. When may a company reduce its capital: (*a*) Without leave of the Court; (*b*) With leave of the Court?

What steps must be taken for reducing capital when the sanction of the Court is necessary? (*Incorporated Accountants.*)

13. What is the difference between the Memorandum and the Articles of Association of a company, and what in particular must be stated in the Memorandum? To what class of companies, and to what extent, do the regulations of Table A apply? (*Incorporated Accountants.*)

14. What are the provisions of the Companies Act, 1929, with respect to the (*a*) Registration of Articles; (*b*) application of Table A; (*c*) form and signature of Articles; (*d*) alteration of Articles?

15. Is there any limitation on the right of a company to alter its Articles? (*Royal Society Arts.*)

16. The prospectus of a company contained certain statements that were false. Can X, a shareholder in the company, set aside his share contract, and, if so, what must he prove? (*Central Association Accountants.*)

17. What are the matters which must be stated in the prospectus? If a prospectus contains false statements, how far is a director liable to indemnify a person injured by them? (*Royal Society Arts.*)

18. What is the general liability of directors for statements made in a prospectus; and in what cases can they relieve themselves of such liability? (*Incorporated Accountants.*)

19. How does the law now stand as regards the disclosure of contracts in a prospectus? (*Chartered Accountants.*)

20. What particulars must the prospectus of a company now contain with respect to: (*a*) Shares and debentures previously issued; (*b*) Names of vendors; (*c*) Material contracts? Who is included under the term "vendor" for this purpose? (*Incorporated Accountants.*)

21. What do you understand by the term "Promoter"? What is his position as regards the company?

22. What are (*a*) preliminary contracts, and (*b*) preliminary expenses in connection with a company? In what circumstances is a company liable in respect of these contracts and expenses?

23. Define Vendor in connection with a company. What are the details regarding Vendors that must appear in the prospectus?

24. The first directors of a company are usually named in the Articles: what must be done by the directors before such an appointment is valid? (*Central Association Accountants.*)

25. How are Directors appointed? What is their position as regards the company? How are their duties and remuneration defined and fixed?

26. State what you know as to the use by a company of its Common Seal. When may a company have an Official Seal, and what is its purpose?

27. Distinguish between Underwriting Commission and Commission on placing Shares, and define your duties as auditor with regard to each. (*Incorporated Accountants.*)

28. In what circumstances, and subject to what conditions, may commissions for underwriting be paid? (*Chartered Institute Secretaries.*)

29. The O.L.M. Co., Ltd., was formed with a capital of £100,000 in £1 shares, the whole amount being issued to the public. The underwriting was as follows: A, 35,000; B, 20,000; C, 30,000; D, 10,000; E, 2,000; F, 3,000.

All marked forms were to go in relief of the underwriters whose name they bear.

The applications on forms marked by the underwriters were: A, 10,000; B, 20,000; C, 22,500; D, 7,500; E, nil; F, 5,000.

Applications for 20,000 shares were received on forms not "marked."

Draw up a statement showing the number of shares each underwriter had to take up. (*Chartered Accountants.*)

30. What are the "powers and duties of auditors" under the Companies Act, 1929? (*Chartered Accountants.*)

31. Can the directors of a limited liability company fix the remuneration of the auditors, or must the same be approved by the members in general meeting? Comment hereon. (*Central Association Accountants.*)

32. If a person other than a retiring auditor to a limited liability company is nominated for the appointment, what formalities are necessary according to Section 132 of the Act of 1929? (*Central Association Accountants.*)

33. What is meant by "Allotment of Shares"? When and how does an allottee become a member of the company? (*Royal Society Arts.*)

34. The Articles of Association of a company permit the directors to receive from shareholders payment in advance of their calls, allowing them interest on such advances. Is such interest necessarily dependent upon profits, and how should interest due and paid under such an arrangement be treated in the Profit and Loss Account? (*Chartered Accountants.*)

35. What are Share Warrants? What rights are conferred by statute on the bearers of such warrants? (*Chartered Accountants.*)

36. Explain the terms: (1) Nominal Capital; (2) Issued Capital; (3) Subscribed Capital; (4) Paid-up Capital; and (5) Unpaid Calls. Illustrate your answer by showing how these items are stated in the balance sheet of a limited company. (*Chartered Institute Secretaries.*)

37. Explain the meaning, and contrast the advantages, of the following classes of Shares: Preference Shares; Cumulative Preference Shares; Ordinary Shares; Participating Ordinary Shares; Founders' Shares. (*Royal Society Arts.*)

38. Explain the following classes of shares: (1) Ordinary; (2) Cumulative Preference; (3) Deferred Ordinary; (4) Management; (5) Founders'. (*Chartered Institute Secretaries.*)

39. Define the following: (*a*) Ordinary Shares; (*b*) Ordinary Stock; (*c*) Cumulative Preference Shares; (*d*) Debentures. (*Central Association Accountants.*)

40. What is a "Cumulative Preference Share"? The A B Company is three years in arrear with the dividends on its 1,000 6 % Cumulative Preference Shares of £1 each. Would this fact affect the annual accounts? If so, how? (*Royal Society Arts.*)

41. What is a Debenture? Give a draft of the principal terms and conditions which might be expected to be found contained therein. (*Central Association Accountants.*)

42. What is usually the primary object, and what are the principal advantages, of collaterally securing debentures by a trust deed? (*Chartered Accountants.*)

43. What is a Floating Charge? How far is it liable to be postponed to the rights of other creditors? (*Royal Society Arts.*)

44. In what circumstances may debentures be re-issued by a company after they have been paid off or purchased by the company? (*Chartered Accountants.*)

45. A company issues 8 % Notes. How do these differ from 8 % Debentures?

46. State the circumstances in which interest may be allowed on calls paid in advance, and give the entries necessary to record such interest in the books of a limited company. (*Royal Society Arts.*)

CHAPTER X

JOINT STOCK COMPANIES—*Continued*

STATISTICAL RECORDS, ETC.

[NOTE.—The references are to the *Companies Act*, 1929, unless otherwise stated.]

BESIDES the ordinary double-entry records that are necessary for the preparation of true accounts of all income and expenditure, and of the assets and liabilities of a limited company, there are certain other books, registers, and records that a limited company is, by Statute, bound to keep, and still others which, by reason of their constitution and management, limited companies have found it convenient to keep. In addition, there are sundry documents, returns, notices, etc., which a limited company must, by Statute, file with the Registrar of Joint Stock Companies. Further, while the business which a particular company exists to carry on is transacted on behalf of the shareholders by the Directors, the control of a limited company vests in the general body of shareholders. The acts of the Directors, meeting as such, must, by Statute, be duly recorded in Minute Books, and the control of the shareholders over their business must be exercised in the manner prescribed by Statute. These matters are briefly dealt with in this chapter.

Statutory Books and Documents, other than Books of Account.

(1) *Register of Members* containing the particulars set out in S. 95, and *Index* thereto, if the members exceed fifty and the Register is not Alphabetical (S. 96).

(2) A record consisting of copies of the *Annual Return*, which must appear in a separate part of the Register of Members, giving the particulars required by SS. 108–111.

(3) *Minute Books* to record proceedings at General and Extraordinary Meetings of the Company, and at the meetings of Directors or Managers (S. 120).

(4) *Register of Directors and Managers* (S. 144).

(5) *Register of Mortgages and Charges* (S. 88).

(6) In addition to the register of mortgages, a copy of every instrument creating any mortgage or charge must be kept (S. 87).

Non-Statutory Books.

(1) *Agenda Book.*—One of the secretary's duties is to draw up in orderly form the various items of business to be transacted at Directors' and Shareholders' meetings. These *agenda*, i.e. things to be done, are entered on the left-hand page of a book, the right-hand page of which is left blank for the chairman to enter his own remarks regarding any particular item of business transacted. In many cases the agenda are typed on loose sheets which can be destroyed when the fair copy minutes have been signed.

(2) *Call Book* (*see* p. 356).

(3) *Debenture Interest Book* (*see* p. 396).

(4) *Directors' Attendance Book.*—This, as the name implies, is a book in which each Director present at any particular meeting signs his name or initials as evidence of his presence at that meeting.

(5) *Dividend Book* (*see* p. 370).

(6) *Register of Allotment Sheets* (*see* p. 289).

(7) *Register of Allotment Returns* (*see* p. 290).

(8) *Register of Certifications and Balance Tickets* (*see* p. 335).

(9) *Register of Debenture Holders* (*see* p. 328).

(10) *Register of Debenture Stock Holders.*

(11) *Register of Powers of Attorney.*—In this register, brief particulars are recorded of the grantors and holders of these instruments and the dates on which they expire. Unless such instruments are registered with the company, acts purporting to be done under them will not be recognised. Companies usually charge a fee of 2s. 6d. for registering these documents.

(12) *Register of Probates* (*see* p. 329).

(13) *Register of Sealed Documents* (*see* p. 329).

(14) *Register of Share Certificates.*

(15) *Register of Stock* (where stock is issued or shares are converted into stock).

(16) *Register of Stockholders* (*see* p. 328).

(17) *Register of Transfers* (*see* p. 331).

(18) *Transfer Fee Cash Book* (*see* p. 332).

Summary of Documents to be Filed with the Registrar.

(1) Memorandum of Association (S. 12).

(2) Articles of Association (SS. 6 and 12).

(3) Declaration as to Compliance with Regulations (S. 15, ss. 2, and S. 94, ss. 1 [*c*] or S. 94, ss. 2 [*c*]).

(4) Statement of Nominal Capital.

(5) Annual return of Capital, Members, and Directors (SS. 108 to 110), with certificates from Private Companies (S. 111).

(6) Nature of Consolidation of Shares, or conversion of shares into stock, or reconversion of stock into shares, or subdivision of shares, or redemption of redeemable preference shares, or cancellation of shares (S. 51).

(7) Returns as to Increase of Capital or of Members (S. 52).

(8) Reduction of Capital (SS. 55, 58, 118).

(9) Notices of Situation of, or change of, Registered Office (S. 92), Situation, or change, of office where a Dominion Register, if any, is kept (S. 103)

(10) Statutory Report (S. 113).

(11) Copies of Special or Extraordinary Resolutions (S. 118).

(12) Copy of Register of Directors or Managers and notification of changes therein (S. 144).

(13) List of Directors, and Consent of Directors to act, and undertakings to take qualification shares or statutory declaration that the requisite shares are registered in the names of the Directors (S. 140)

(14) Prospectus (S. 34) or Statement in Lieu of Prospectus (S. 40).

(15) Actual contracts, or, if not in writing, Particulars of Contracts in respect of Shares issued otherwise than for Cash (S. 42).

(16) Returns of Allotments (S. 42).

(17) Particulars of Mortgages, and Charges (SS. 79, 80 and 81).

(18) Memorandum of Satisfaction of Mortgage or charge and declaration verifying same (S. 84).

(19) Statement of Commission paid on issue of Shares (S. 43).

(20) Office Copy of Order of Court sanctioning compromises, arrangements, reorganisation of Capital, etc. (S. 153), or for facilitating reconstruction and amalgamation (S. 154).

(21) Printed copy of Memorandum where objects have been altered, with copy of order of Court (S. 5).

(22) Special statement in lieu of prospectus where private company ceases to be such (S. 27).

(23) Copy of Order of Court regarding variation of Shareholders' rights (S. 61).

(24) Notice of appointment of Receiver or Manager (S. 86).

(25) Notice of rectification of Register of Members on Order of Court (S. 100).

(26) Copies of Balance Sheet, Auditor's Report, etc. (S. 130).

(NOTE.—The documents required to be filed on winding-up are not included above.)

Register of Members.—Persons may become members of a company by (*a*) Signing the Memorandum, (*b*) Applying for and being allotted shares, (*c*) Transfer of shares by an existing member. The shares of a deceased member vest in, and may be transferred by, his executor or administrator; the shares of a bankrupt vest in and may be transferred by the Trustee.

Every company must keep, in one or more books, a register of its members and enter therein the following particulars :—

(*a*) Names, addresses, and occupations of the members, and a statement of the shares held by each member, distinguishing each share by its number, and the amount paid or agreed to be considered as paid on the shares of each member, or the amount of stock held by each member.

(*b*) The date at which each person was entered in the register as a member.

(*c*) The date at which any person ceased to be a member.

There is no statutory form of Register, but the form illustrated on p. 320 complies with modern usage. It combines the Members' Register with the Share Ledger. It is a convenience to keep separate Registers for each class of share issued—Ordinary, Preference, etc. In the case of small companies, the Transfer Register is included in the Members' Register. The Register must date from the registration of the company, but pending the preparation of the complete register the Application and Allotment Sheets may be regarded as fulfilling temporarily the requirements of the Statute. The Register may be contained in as many separate books as may be necessary. Large companies, whose shares are dealt in actively, must clearly sub-divide the Register in order to facilitate the heavy transfer work.

The date of entry should be the actual date on which the entry was made in the register (since a person is not a member until his name is entered in the Register), or the date of transfer. The date of ceasing to be a member should be the date when the transfer was passed by the Directors.

With the exception of notifications received from the Public Trustee, no notice of any trust shall be entered on the register, or be receivable by the Registrar in the case of companies registered in England (S. 101).

Index of Members.—Every company having more than fifty members must, unless the register of members is in such a form as to constitute in itself an index, keep an index of the names of members. The index may be in the form of a card index (S. 96).

Inspection of Register.—The Register and the index thereto must be kept at the registered office of the company, and be open for inspection for not less than two hours per day during business hours by members free of charge, and by the general public on payment of 1s. or such less sum as the company prescribes (S. 98). A company may, on giving due notice by advertisement, close its Register for a total period not exceeding thirty days in the year (S. 99). Usually, Registers are closed for fourteen days prior to the Annual General Meeting for the purpose of preparing the dividend and voting lists.

Companies whose objects comprise the transaction of business in a dominion may, if so authorised by the Articles, keep their Dominion

COMBINED REGISTER OF MEMBERS AND SHARE LEDGER.

Name ....
Address ....
Description ....

Date of entry as a member ....
Date of ceasing to be a member ....

Dr.	Shares Acquired.						Dr.	Cash due on Shares.									
Date.	No. of Allotment or Transfer Deed.	No. of Shares Acquired.	Class of Share.	Distinctive Numbers of Shares.		Details.	Folio.	Total Amount of Holding.			Date of Calls	Amount due per Share.			Class of Share.	Total Amount Payable on Shares.		
				From	To			£	s.	d.		£	s	d.		£	s.	d.

Cash Paid on Shares.				Cr.			Shares Disposed of.							Cr.		
Due Date.	How Paid.	When Paid.	C.B. Folio.	Amount.			Date.	No. of Transfer Deed.	Folio in Transfer Register.	No. of Shares Disposed of.	Class of Share.	Distinctive Numbers.		Total Value of Shares Disposed of.		
				£	s.	d.						From	To	£	s.	d.

Note.—A " Balance " Column is useful where transfers are numerous.

Branch Registers in that Dominion, but duplicates of such Registers must also be kept at the Registered Office of the company (SS. 103 and 104).

Any person may demand a copy of the Register, or of any part thereof, on payment of 6d. per 100 words, or fractional part thereof. Such a copy must be sent to the person demanding it within ten days after the demand is received by the company (S. 98, ss. [2]).

Posting Share Register.—This is done from the Application and Allotment Sheets already described, and from the Call Book for the subsequent calls. From these sources, the names, addresses, occupations, number of shares with their distinctive numbers, of each shareholder are obtained, and also the amounts due on application, allotment, and calls. These amounts furnish the *debit* against each shareholder. The Cash Book (or Shareholders' Cash Book, or loose Application and Allotment Sheets, if the issue be a large one) gives details of the payments made by shareholders (application, allotment, first call, etc.) and the posting of these particulars completes the *credit* side of the Share Register. Shares subsequently sold and transferred will be posted from the Transfer Register, or Transfer Guard Book, to the relative Accounts of the old and new shareholders. The accuracy of the Share Register can be tested at any time, seeing that the detail balances should tally with the amount of capital the company has called up *less* calls in arrear *plus* calls paid in advance.

Annual Return.—It has already been stated (*see* p. 287) that an initial return must be made of a company's subscribed capital, and of any increases thereof. In addition to this every company having a share capital must at least once in every year make a list of all persons who, on the fourteenth day after the first or only ordinary general meeting in the year, are members of the company, and of all persons who have ceased to be members since the date of the last return or (in the case of the first return) of the incorporation of the company (S. 108 [1]).

The list must state the names, addresses, and occupations of all the past and present members therein mentioned, and the number of shares held by each of the existing members at the date of the return, specifying shares transferred since the date of the last return (or, in the case of the first return, of the incorporation of the company) by persons who are still members and have ceased to be members respectively and the dates of registration of the transfers, and if the names are not arranged in alphabetical order, an index is necessary. If stock has been created, the amount of stock held must be stated instead of the particulars as to shares (S. 108 [2]).

The return must also state the address of the registered office, and must contain a summary distinguishing between shares issued for cash, and shares issued as fully or partly paid up otherwise than in cash, and specifying the particulars set out in S. 108 [3] (*a*) to (*o*).

Number of Company .... [FORM No. 6A1.

[PUBLIC COMPANY]

THE COMPANIES ACT, 1929.

FORM OF ANNUAL RETURN OF A COMPANY HAVING A SHARE CAPITAL.

As required by Part IV of the Companies Act, 1929 (Section 108).

A Companies Registration Fee Stamp of 5s. must be *impressed* here.

ANNUAL RETURN OF .... LIMITED, MADE UP TO THE .... DAY OF ...., 19.. (BEING THE FOURTEENTH DAY AFTER THE DATE OF THE FIRST OR ONLY ORDINARY GENERAL MEETING IN 19..).

The Address of the Registered Office of the Company is as follows:—

....

....

SUMMARY OF SHARE CAPITAL AND SHARES.

1. Nominal Share Capital, £........ divided into* { .... / .... } Shares of ..	£* ...... each £* ...... each
2. Total Number of Shares taken up* to the .... day of ...., 19 ., being the date of the Return (which Number must agree with the Total shown in the List as held by existing Members)	....
3. Number of Shares issued subject to payment wholly in Cash	....
4. Number of Shares issued as fully paid up otherwise than in Cash	....
5. Number of Shares issued as partly paid up to the extent of .... per Share otherwise than in Cash	....
6. †Number of ...... Shares (if any) issued at a discount	....
7. †Number of ...... Shares (if any) issued at a discount	....
8. Total amount of discount on the issue of Shares which has not been written off at the date of this Return	£............
9. ‡There has been called up on *each* of .... Shares	£............
10. ‡There has been called up on *each* of .... Shares	£............
11. ‡There has been called up on *each* of .... Shares	£............
12. §Total Amount of Calls received, including Payments on Application and Allotment	£............
13. Total Amount (if any) agreed to be considered as paid on .... Shares which have been issued as fully paid up otherwise than in Cash	£............
14. Total Amount (if any) agreed to be considered as paid on .... Shares which have been issued as partly paid up to the extent of .... per Share otherwise than in Cash	£............
15. Total Amount of *Calls* unpaid	£............
16. Total Amount of the sums (if any) paid by way of Commission in respect of any Shares or Debentures or allowed by way of Discount in respect of any Debentures since the date of the last Return	£ ....
17. Total Number of Shares forfeited	....
18. Total Amount paid (if any) on Shares forfeited	£............
19. Total Amount of Shares for which Share Warrants to Bearer are outstanding	£............
20. Total Amount of Share Warrants to Bearer issued and surrendered respectively since the date of the last Return .. . { Issued / Surrendered }	£............ £............
21. Number of Shares comprised in each Share Warrant to Bearer	....
22. Total Amount of the Indebtedness of the Company in respect of all Mortgages and Charges of the kind which are required (or, in the case of a Company registered in Scotland, which, if the Company had been registered in England, would be required) to be registered with the Registrar of Companies under The Companies Act, 1929	£ ....

NOTE.—Banking Companies must add a list of all their places of business.

* Where there are Shares of different kinds or amounts (e.g. Preference and Ordinary, or £1 and 1s.), state the number and nominal values separately.

† If the Shares are of different kinds, state them separately.

‡ Where various amounts have been called, or there are Shares of different kinds, state them separately.

§ Include what has been received on forfeited as well as on existing Shares.

The Return must be signed, *at the end*, by a Director or by the Manager or Secretary of the Company.

Copy of Last Audited Balance Sheet of the Company.

Note.—Except where the Company is (1) a "Private Company" within the meaning of Section 26 of The Companies Act, 1929, or is (2) an Assurance Company which has complied with the provisions of Section 7 (4) of The Assurance Companies Act, 1909, this Return must include a written copy, certified by a Director or by the Manager or Secretary of the Company to be a true copy, of the last Balance Sheet which has been audited by the Company's Auditors (including every document required by law to be annexed thereto) together with a copy of the Report of the Auditors thereon (certified as aforesaid), and if any such Balance Sheet is in a foreign language there must also be annexed to it a translation thereof in English certified in the prescribed manner to be a correct translation. If the said last Balance Sheet did not comply with the requirements of the law as in force at the date of the audit with respect to the form of balance sheets there must be made such additions to and corrections in the said copy as would have been required to be made in the said Balance Sheet in order to make it comply with the said requirements, and the fact that the said copy has been so amended must be stated thereon.

Capital and Liabilities.	Assets.

Particulars of the *Directors of .... Limited, at the date of the Annual Return.

† The present Christian Name or Names and Surname.	Any former Christian Name or Names or Surname.	Nationality.	Nationality of Origin (if other than the present Nationality).	Usual Residential Address.	‡ Other Business Occupation if any. If none, state so.

* "Director" includes any person who occupies the position of a Director by whatever name called, and any person in accordance with whose directions or instructions the Directors of a Company are accustomed to act.

† In the case of a Corporation its Corporate Name and Registered or Principal Office should be shown.

‡ In the case of an individual who has no business occupation but holds any other directorship or directorships, particulars of that directorship or of some one of those directorships must be entered.

List of Persons holding Shares in .... Limited, on the .... day of ...., 19.., and of Persons who have held Shares therein at any time since the date of the last Return, or (in the case of a first Return) of the Incorporation of the Company, showing their Names and Addresses, and an Account of the Shares so held.

N.B.—If the names in this list are not arranged in alphabetical order, an Index sufficient to enable the name of any person in the list to be readily found must be annexed to this list.

Folio in Register Ledger, containing Particulars.	Names, Addresses, and Occupations.				Account of Shares.					Remarks.
	Surname.	Christian Name.	Address.	Occupation.	*Number of Shares held by existing Members at date of Return.†	‡ Particulars of Shares Transferred since the date of the last Return, or (in the case of a first Return) of the incorporation of the Company, by Persons who are still Members.		‡ Particulars of Shares Transferred since the date of the last Return, or (in the case of a first Return) of the incorporation of the Company, by Persons who have ceased to be Members.		
						Number.†	Date of Registration of Transfer.	Number †	Date of Registration of Transfer.	

(Signature) .. ..

(State whether Director or Manager or Secretary) ....

* The aggregate Number of Shares held, and *not* the Distinctive Numbers, must be stated, and the Column must be added up throughout so as to make one total to agree with that stated in the Summary to have been taken up.

† When the Shares are of different classes these Columns may be sub-divided so that the number of each class held, or transferred, may be shown separately. Where any Shares have been converted into Stock the amount of the Stock held by each Member must be shown.

‡ The *date of registration* of each Transfer should be given, as well as the Number of Shares transferred on each date. The particulars should be placed opposite the name of the Transferor, and *not* opposite that of the Transferee, but the name of the Transferee may be *inserted in* the "Remarks" column, immediately opposite the particulars of each Transfer.

The return must also (except where the company is a private company) include a written copy of the last Balance Sheet, auditor's report, and other documents required by law to be annexed to the Balance Sheet. A copy of the Profit and Loss Account is not required (s. 110 [3]).

This list and summary must be completed within twenty-eight days after the first or only general meeting in the year, and the company must forthwith forward to the Registrar of Companies a copy signed by a Director or by the Manager or by the Secretary of the company (S. 110 [1]). The filing fee payable to the Registrar is 5s.

The information required by the Act, and the method of presenting it, is explained on pp. 322–324.

The *Copy of the Balance Sheet*, which forms part of the return, is not required in the case of private companies, though they are not otherwise exempt from filing the return. But, by S. 111, private companies must accompany the annual return with a certificate signed by a Director or the Secretary stating that no public offer of shares or debentures has been made, and that, should the members exceed fifty in number, the excess is composed of employees or ex-employees.

A copy of the return as filed is made at the end of the Register of Members, but in large companies a duplicate copy is usually made on the official Form 6A used for the return, and is then bound up with previous returns in book form.

No return need be filed after the statutory meeting.

Minute Books.—By S. 120 every company shall cause minutes of all proceedings of general meetings and of its directors or managers to be entered in books kept for that purpose. Any minutes made therein purporting to be signed by the chairman of the meeting, or by the chairman of the next succeeding meeting, shall be evidence of the proceedings. Until the contrary is proved, every meeting whereof minutes have been so made shall be deemed to have been duly held and convened, and all proceedings to have been duly had, and all appointments of directors, managers, or liquidators to be valid.

Eminent counsel have advised that the words "Books of the Company" to which, under S. 134, auditors have right of access, include the Minute Books and Letter Books.

The minute books of general meetings are open to the inspection of any member during business hours, subject to such reasonable restrictions as the company may by its articles or in general meeting impose, but so that not less than two hours in each day are allowed for inspection. Any member may obtain a copy at a charge not exceeding 6d. per hundred words (S. 121).

Register of Directors and Managers.—By S. 144, every company shall keep at its registered office a register containing the names and addresses and occupations of its directors or managers, and send to the Registrar of Companies a copy thereof, within fourteen days of

the appointment of the first directors or of any change in the particulars.

Register of Mortgages and Charges.—By S. 79 (1), every mortgage or charge created by a company (*a*) for the purpose of securing a debenture issue; or (*b*) on uncalled share capital; or (*c*) by an instrument which, if executed by a private person, would require to be registered as a bill of sale; or (*d*) on any land or interest therein; or (*e*) on any book debts; or (*f*) being a floating charge on the undertaking or property of the company; or (*g*) a charge on unpaid calls; or (*h*) on a ship or any share in a ship; or (*i*) on goodwill, on a patent or licence under a patent, on a trademark, or on a copyright or a licence under a copyright, is void as a security against the liquidator or any creditor of the company unless the instrument (if any) and prescribed particulars of the mortgage or charge is delivered to the Registrar for registration within twenty-one days after the date of its creation. That is, in the event of liquidation, or against an execution creditor, the lenders under an unregistered mortgage or charge are merely unsecured creditors. But on failure to register, the moneys secured by such a mortgage or charge immediately become payable.

The Registrar must keep in the prescribed form a register for each company of such mortgages and charges, and enter therein the date of creation of every such mortgage or charge, the amount secured by it, short particulars of the property mortgaged or charged, and the names of the mortgagees or persons entitled to the charge (S. 82 [1]). This Register forms part of the company's file at Somerset House, and anyone may inspect it on payment of 1s. (S. 82 [3]).

The Registrar must give a certificate of any mortgage or charge registered by him, and this certificate is conclusive evidence that the requirements of the Act as to registration have been complied with (S. 82 [2]).

The Registrar must keep a chronological index in the prescribed form and with the prescribed particulars of the mortgages or charges registered with him under the Act (S. 82 [4]).

By S. 88, every limited company must keep a register of mortgages and enter therein all mortgages and charges specifically affecting property of the company and all floating charges, giving in each case similar particulars to those the Registrar is required, by S. 82 [1], to enter in his register. A form of this register is shown on p. 327.

This company's register, together with copies of instruments creating any mortgage or charge, must be kept open for inspection at all reasonable times by any creditor or member of the company without charge, and the register itself for the inspection of any other person at a fee not exceeding 1s. per inspection (S. 89).

It will be seen that the registration of mortgages or charges is a double one: registration both by the company and the Registrar. The object of registration is to ensure that the creditors of a company

REGISTER OF MORTGAGES

No. of Charge.	Date of Mortgage or Charge.*	Brief *Description* of the Property Charged.	Rate of Interest.			Amount of the Charge.			Mortgagees.		Date Filed with Registrar.	Date of Memorandum of Satisfaction.
									Name.	Address.		
			£	s.	d.	£	s.	d.				

* If the charge was a charge existing on property acquired by the Company, enter the date of acquisition of the property.

STOCK HOLDERS REGISTER.

Name of Stock Holder ....
Address ....

Description..............................
Date of entry as a Member ....
Date of ceasing to be a Member ....

Stock Acquired.							Stock Transferred.							Remarks.
Date.	No. of Transfer.	Name of Transferor.	Folio.	Amount Acquired.			Date.	No. of Transfer.	Name of Transferee.	Folio.	Amount Transferred.			
				£	s.	d.					£	s.	d.	

STOCK REGISTER.

Holders.				Particulars of Shares Converted.							Particulars of Stock Created.					Remarks.
Name.	Address.	Description.	Share Ledger Folio.	Certificate Number.	No. of Shares.	Distinctive Numbers.		Amount.			Certificate Number.	Stock Register Folio.	Amount.			
						From	To	£	s.	d.			£	s.	d.	

DEBENTURE HOLDERS REGISTER.

Name : *Robert Radford.* Address : 162 *Sutton Road, Streetley.* Description : *Gentleman.*

Debentures Acquired.										Debentures Disposed of.								
Date.	No. of Allotment Letter or Transfer Deed.	Name of Transferor.	Ledger Folio.	No. of Bonds or Certificates.	Distinctive Numbers of Bonds.		Value.			Date.	No. of Transfer.	Name of Transferee.	No. of Bonds or Certificates.	Distinctive Numbers of Bonds.		Value.		
					From	To	£	s.	d.					From	To	£	s.	d.
19.. Dec. 8	321	Dick, Geo.	32	5	5	9	250	0	0	19.. Jan. 2	581	Coe, John	2	5	6	100	0	0

get due notice of the creation of all charges on the company's assets. When a charge is paid off, a *Memorandum of Satisfaction* in the prescribed form should be filed with the Registrar, who will duly note the fact (S. 84).

Register of Stockholders.—Where stock has been issued it is necessary to keep a register of the holders, and of the shares converted into stock (*see* p. 328).

Register of Probates.—This is a Register used to record brief details of probates and letters of administration, etc., respecting the estates of deceased shareholders. A fee of 2s. 6d. is usually charged by companies for registration.

Register of Debenture Holders.—Since debenture holders are not members of the company, it is not compulsory to keep this book, but it is the usual practice so to do. The Register contains particulars of the names and addresses of the debenture holders together with particulars of their holdings. If the debentures are not fully paid, the Register must contain accommodation for the cash transactions between the company and the holders. If kept, the Register is open to inspection by debenture holders and shareholders, and copies may be demanded on payment of the prescribed fee. Any debenture holder or shareholder may obtain a copy of any trust deed securing debentures on payment of the prescribed fee (S. 73). A form of this Register is shown on p. 328.

The Register of Debenture Holders is posted from the Debenture Application and Allotment Sheets, and from the Debenture Cash Book, or, in small issues, the Cash Book proper. Changes of ownership are recorded in, and posted from, the *Debenture Transfer Register* (*Transfer Guard Book*). This latter register is similar in principle to the Share Transfer Register and need not be illustrated here.

Register of Debenture Stockholders.—If debenture stock has been issued, a register identical in principle to the Stock Holders Register given on p. 327 must be kept. Columns are provided in this register for details of the debenture stock acquired, number of the certificate, stock transferred or redeemed, and for showing the balance of stock still held.

Register of Sealed Documents.—In this register are recorded brief details of all documents that have been sealed by the company (*see* p. 280).

Register of Transfers.—A Register of Transfers is not compulsory, except in the case of Parliamentary companies, but it is necessary that a proper record should be kept of all transfers accepted by the company. A form of Register is given on p. 331.

Separate registers should be kept for each class of share. In small companies provision is usually made for the Register of Transfers at the end of the Share Ledger.

It is, perhaps, more usual in these days to keep a *Transfer Guard Book*, in which the actual transfer deeds are pasted in numerical order. The numbers of the old and new certificates, the distinctive numbers of the shares, and the folios of the members are noted on the transfer, and the posting is then made direct from the deeds to the Share Register. Another modern practice is to file transfers in a loose-leaf binding case. Debenture transfers are dealt with on precisely similar lines to share transfers, and no further illustration need be given. Separate registers must be kept for each class of share or debenture.

Share and Stock Transfers.—All securities can be transferred on sale whether they be inscribed, registered, or bearer securities, although in the last-mentioned case ownership usually passes by mere delivery. Every member of a limited company has a statutory right to transfer his shares subject to any restrictions on transfer imposed by the Articles. In private companies there must be such restrictions. In the absence of power in the Articles, directors have no right to refuse to register transfers (*Weston's* case [L.R. 4 Ch. 20]). Where discretionary power exists, Directors may decline to register transfers without giving any reason. But such powers must be exercised for the benefit of the company and not for individuals (*Bennett's* case [1854]). The Stock Exchange will not grant a quotation to any company possessing power to refuse transfers.

In connection with transfers, Lindley, L.J., in *Taylor, Phillips & Rickard's Case* [1897], said: "The word share does not denote rights only—it denotes obligations also; and when a member transfers his share he transfers all his rights and obligations as a shareholder as from the date of transfer. He does not transfer his rights to dividends * or bonuses already declared, nor does he transfer liabilities in respect of calls already made; but he transfers his rights to future payments and his liabilities to future calls."

On the death of a shareholder, his shares automatically pass to his executor or administrator as personal estate. The estate is liable for uncalled liability, but the executor is under no personal liability unless he requests to be placed on the register (*Buchan's* case [1879]). For these reasons executors very rarely register,† as, in their representative capacity, they can execute transfers upon sale of the shares after registration of probate with the company. On the death of a joint holder, the shares vest in the survivor, and a death certificate will be accepted by the company as sufficient evidence. On bankruptcy,

* But shares transferred on the Stock Exchange after the dividend has been declared or paid but *before* such shares are, by the Stock Exchange Rules, quoted *ex div.*, transfer to the purchaser the right to the dividend, which must be paid over to him by the vendor.

† In some cases, the Articles empower the directors to compel representative holders to register the shares in their own or a nominee's name.

Grant, Wood & Co., Ltd.

TRANSFER REGISTER.

Number of Transfer.	Date Transfer Lodged.	Date of Transfer Deed.	Transferor's			Transferor's Folio in Share Register.	Shares Transferred.								Transferee's			Transferee's Folio in Share Register.	Number of New Certificate.
			Name.	Address.	Occupation.		Number.	Amount per Share paid.	Capital paid up.			Distinctive Numbers.			Name.	Address.	Occupation.		
									£	s.	d	From	To						
121	19... Mar. 6	19... Mar. 5	*Jones*, Owen	Llantry-sant	Farmer	69	2000	£1	2,000	0	0	72096	74095		*Norman*, Henry	1754 Cannon St., E.C.	Chartered Accountant	172	1046
207	April 9	April 8	*Norman*, Henry	1754 Cannon St., E.C.	Chartered Accountant	172	1500	£1	1,500	0	0	34001 72096	35000 72595		*Higgins*, Abel	Aberystwyth	Saddler	428	1362
212	April 15	April 8	*Norman*, Henry	1754 Cannon St., E.C.	Chartered Accountant	172	1500	£1	1,500	0	0	72596	74095		*Morris*, John James	Westmeath, Sleaford	Farmer	461	1382
															(*Signed*)	ISIDORE	GRANT, *Chairman*.		

the debtor's shares are in the disposition of the trustee, who can transfer them on the same conditions as the bankrupt could have done, or he can disclaim any shares on which there is a liability for uncalled capital.

Form of Transfer.—A transfer must be in writing (S. 63). The particular form of transfer prescribed by the company's Articles must be used. Sometimes the form of transfer is set out in the Articles (Table A, clause 18, gives a form of transfer). In the great majority of cases, the common form of transfer given on p. 333 is accepted.

This common form transfer can be obtained from any law stationer. Its use is compulsory if a Stock Exchange quotation is to be obtained. Companies will not accept transfers which deal with more than one class of share. Transfers sent for registration must be accompanied by the relative share certificates, and the transfer fee which, usually, is 2s. 6d. per deed. Transfer fees are posted to a "Transfer Fee Account" in the Ledger, and duly appear, in a single total, on the credit side of the Profit and Loss Account.

Transfer Fees Book.—In large companies, where dealings in the shares are numerous, a Transfer Fees Book, ruled as under, is kept to record the receipt of transfer fees. The totals from this book are entered at intervals in the General Cash Book. In some cases, the transfer work is handed over to an outside Registrar, in which case the fees go to him in whole or part payment for his services. When that is so, no entries for transfer fees are made in the company's books.

TRANSFER FEES BOOK.

Date.	No. of Transfer.	Paid by	Amount.			Remarks.
			£	s.	d.	

Transfer Stamp Duties.—Transfers are subject to the payment of an *ad valorem* stamp duty, and companies are under a statutory obligation to see that transfers are duly stamped. Stamps must be impressed on the following scale :—

Consideration not exceeding £	Stamp Duty. £	s.	d.	Consideration not exceeding £	Stamp Duty. £	s.	d.
5	0	1	0	125	1	5	0
10	0	2	0	150	1	10	0
15	0	3	0	175	1	15	0
20	0	4	0	200	2	0	0
25	0	5	0	225	2	5	0
50	0	10	0	250	2	10	0
75	0	15	0	275	2	15	0
100	1	0	0	300	3	0	0

SHARE TRANSFER.

Impressed Stamp £10.

I, *Owen Jones*, *of Llantrysant*, *Farmer*, in consideration of the sum of [See Note at Foot.] *Two thousand pounds* paid by *Henry Norman*, *of* 1754 *Cannon Street*, *E.C.*, *in the City of London*, *Chartered Accountant*, hereinafter called the said Transferee,

Certificate of the within mentioned 2,000 *Shares* has been lodged at the Company's Office, ROBERT WOOD, *Secretary*.

Do hereby bargain, sell, assign and transfer to the said Transferee :—*Two thousand* (2,000) *fully paid shares of one pound each*, *numbered* 72096 to 74095 *inclusive*, of and in the undertaking called *Grant, Wood and Company, Limited.*

To hold unto the said Transferee, *his* Executors, Administrators and Assigns, subject to the several conditions on which *I* held the same immediately before the execution hereof; and *I* the said Transferee do hereby agree to accept and take the said *Shares* subject to the conditions aforesaid.

As Witness our Hands and Seals, this *fifth* day of *March*, in the Year of our Lord One thousand nine hundred and .

Signed, sealed, and delivered, by the above named *Owen Jones*, in the presence of

Witness's
- Signature,* *Michael Macgillicuddy.*
- Address, *Llantrysant, Wales.*
- Occupation, *Farm Bailiff.*

OWEN JONES. SEAL

Signed, sealed, and delivered, by the above named *Henry Norman*, in the presence of

Witness's
- Signature,* *N. Howell.*
- Address, 1754 *Cannon Street, London, E.C.*
- Occupation, *Audit Clerk.*

H. NORMAN. SEAL

Signed, sealed, and delivered, by the above named................in the presence of

Witness's
- Signature * ....
- Address ....
- Occupation ....

.... SEAL

Signed, sealed, and delivered, by the above named................in the presence of

Witness's
- Signature * ....
- Address ....
- Occupation .. ..

.... SEAL

NOTE.—The Consideration-money set forth in a transfer may differ from that which the first Seller will receive, owing to subsales by the original Buyer; the Stamp Act requires that in such cases the Consideration-money paid by the Sub-purchaser shall be the one inserted in the Deed, as regulating the *ad valorem* Duty; the following is the *Clause* in question :—

"Where a Person having contracted for the purchase of any property, but not having obtained a Conveyance thereof, contracts to sell the same to any other Person, and the Property is, in consequence, conveyed immediately to the Sub-purchaser, the Conveyance is to be charged with *ad valorem* Duty in respect of the Consideration moving from the Sub-purchaser"—[54 & 55 VIC., cap. 39 (1891), section 58, sub-section 4].

INSTRUCTIONS FOR EXECUTING TRANSFERS.

* *When a transfer is executed out of Great Britain, it is recommended that the Signatures be attested by H.M. Consul or Vice-Consul, a Clergyman, Magistrate, Notary Public, or by some other person holding a public position—as most Companies refuse to recognise Signatures not so attested. When a witness is a Female she must state whether she is a Spinster, Wife, or Widow: and if a Wife she must give her Husband's Name, Address, and Quality, Profession, or Occupation. The Date must be inserted in Words and not in Figures.*

Over £300, the duty is 10s. for every additional £50 or fraction thereof. Unless these duties are paid within thirty days of execution a penalty is incurred.

If a transfer operates as a gift, or in discharge of a debt, the statutory *ad valorem* duty is payable on a value to be agreed between the transferor and the Inland Revenue; and an "adjudication" stamp must be impressed, as otherwise the transfer is not duly stamped.

Nominal Consideration.—Where a transfer is not made on sale or gift, e.g. where an executor transfers shares to a legatee to whom they have been bequeathed, or a nominee transfers shares to the person for whom he holds them, it is usual to insert a nominal consideration of 10s., and a 10s. stamp only is required. Persons registering a transfer not duly stamped are liable to penalties, and such transfers will not be accepted in evidence in civil proceedings.

Liability of Parties to a Transfer.—The Articles usually empower the directors to refuse to register a transfer of shares upon which all calls have not been fully satisfied. If there are any unpaid calls on shares forming the subject-matter of a transfer, the transferor is liable until the transfer has actually been registered. Under S. 157, there is also a contingent liability after registration. If liquidation supervenes within one year of the registration, the transferor is liable for unpaid calls as a "*B*" *Contributory*, if the "*A*" *List of Contributories* has been exhausted, and the person to whom he transferred his shares fails to meet his liability for the unpaid calls, and debts of the company outstanding when the transferor ceased to be a member of the company still remain undischarged.

Scrutiny of Transfers.—All transfers before being passed are carefully checked as to date, stamp duty, signatures, witnesses, distinctive number of shares, etc. Alterations must be initialled by all parties. As a precaution against fraud, the transferor is usually notified of the lodgment of the transfer, and a record of such notifications is kept in a Notice of Transfers Lodged Book. If the Directors approve the transfer, a resolution to that effect is passed, and the transfer is recorded in the Transfer Register or filed in a Guard Book, initialled by the chairman, and duly posted to the Share Ledger. In due course a new certificate is sealed and forwarded to the transferee.

If a company refuses to register a transfer, it must, within two months after the date on which the transfer was lodged with the company, send to the transferee notice of the refusal (S. 66).

Balance Tickets.—When certificates are lodged embracing more shares than are necessary to satisfy a transfer, a Balance Ticket is issued to the transferor. Balance Tickets are issued free. They form temporary certificates, are accepted on the Stock Exchange, and enable the transferor to deal with the balance of his holding. In due course, they are exchanged, on payment of 1s. fee, for definitive certificates,

the old certificates being cancelled. Particulars of such transactions are recorded in the Register of Certifications and Balance Tickets.

The usual form of Balance Ticket is as follows :—

Ravarys, Limited.

LONDON,
SPENCER HOUSE,
SOUTH PLACE, E.C. 2.

.... 19...

Received from ....

....

Share Certificate No. .... in favour of ....
for .... shares in the above Company, deposited against a Transfer for .... shares.

Balance of shares remaining ....

(Signed) ....
Registrar.

N.B.—*Transfer hours* : 11.30 *to* 2.30, Saturdays excepted.

Blank Transfer.—A blank transfer is a transfer executed by the transferor only, no transferee being named, and no date inserted in the transfer. Such a transfer attached to the relative certificate is frequently deposited as equitable security for a loan—the intention being that the transferor shall, when the agreed event happens, fill in his name, or a purchaser's, and so complete the document. But it is no protection against a fraudulent transferor who, representing to the company that the certificate has been lost, obtains a fresh certificate and then sells the shares. To make the security complete it is well for the lender to serve upon the company a *notice in lieu of distringas*. This ensures that, if any attempt is made by the transferor to transfer the shares elsewhere, the company must give to the mortgagee notice of the fact. The lender can at any time within eight days of the receipt of the notice apply to the Court for an order to prevent the transfer. Where a transfer must by the Articles be by deed, a blank transfer is useless, for as a deed it is void. In that case the borrower should execute a power of attorney, authorising the lender to execute a transfer in the borrower's name, to " sign, seal, and by his act and deed deliver " a transfer of the shares. The notice in lieu of distringas should also be given.

Certification.—The transferor, or his broker, may complete the transfer form so far as the transferor is concerned, and lodge it with the relative certificate at the company's office for " certification." After seeing that the certificate and transfer are *prima facie* in order, the Secretary or Registrar will then impress on the transfer, by means of a rubber stamp, a certificate that a share certificate covering the shares to be transferred has been lodged with the company.

Ravarys, Limited.

A certificate of the within mentioned .... shares has been lodged at the Company's office.

(Signed) ....
Secretary.

The transfer form so certified is accepted by the transferee as sufficient evidence of title, since the company retains the share certificate.

In the case of quoted shares, certification may be done by the Secretary of the Stock Exchange.

Forged Transfers.—A transferee under a forged transfer obtains no rights over the subject-matter of the transfer. But if acting upon a forged transfer, a company issues to the transferee a certificate, then any person who acts on the faith of it and suffers damage is entitled to be compensated by the company (*Bloomenthal's* case, [1897]). The true owner of shares transferred upon a forged transfer is entitled to have his name restored to the Register as owner of the shares. It is not the registration of the transferee's name that gives the right to compensation, but the issue of the certificate, which is *prima-facie* evidence of title to the shares, and upon which a person is entitled to act. Many companies protect themselves against loss through forged transfers by taking out a Lloyd's policy of insurance, or it may build up a Fund, under the Forged Transfer Acts, for the purpose.

Debenture Transfers.—The transfer of debentures is subject to the same regulations, stamp duties, and registration fees as is the transfer of shares. A Debenture Transfer Register is kept to record such transfers, which are effected on principles identical with those already described. Debentures can only be transferred for the fixed sums they represent, e.g. £50, £100, etc. Debenture stock on the other hand can be transferred in any sum.

EXAMINATION QUESTION

What is a mortgage? What records are necessary in the case of a limited company which has mortgaged its freehold property? (*Royal Society Arts.*)

Solution.

Definition.—A mortgage is a conditional transfer of property made by a borrower to secure the repayment of a sum of money at a fixed date, together, usually, with interest thereon. In other words, it is security given by a borrower of money to the lender to cover a loan.

Statistical Records.—A brief description of the property charged, the amount of the charge, and the names and addresses of the mortgagees must be entered in the Register of Mortgages kept at the registered office of the company, as required by S. 88. Similar particulars must also be sent to the Registrar of Joint Stock Companies within twenty-one days for registration in the company's file at Somerset House (S. 80).

Financial Records.—The cash received from the lender must be debited,

on receipt, in the Cash Book, and posted therefrom to the credit of the Mortgage Account. Notes should be made as part of the heading of the Account, recording the due date, the rate of interest payable, and the dates upon which it is payable. Notes should also be made as part of the Ledger headings of the asset accounts charged under the mortgage.

Company Meetings.—Distinctive names are given to the meetings which may, or must, be held by limited companies :—

Statutory Meeting.—This is provided for by S. 113. It is usually the first meeting held. Every limited company, other than a private company, must hold this meeting (unless limited by guarantee without a share capital) not less than one month or more than three months from the date when the company is authorised to commence business. Seven clear days before the meeting, a Statutory Report, in the prescribed form, must be sent to all members, and a copy be filed with the Registrar. This report and the procedure at the meeting are discussed in detail on p. 409. The object of the meeting is to afford shareholders an opportunity to discuss any matter arising out of the formation of the company, and the company's prospects.

Annual General Meeting.—Every company must hold at least one ordinary meeting in every calendar year (S. 112). This ordinary general meeting must be held, under penalty if it be not held, not more than fifteen months after the preceding ordinary general meeting. The statutory meeting is not an ordinary general meeting. At this meeting, the notice convening the meeting is read, the accounts are presented, and the Auditors' Report thereon is read. If the meeting approves the accounts they are passed, and the dividends (if any) proposed to be paid by the Directors are declared. Retiring Directors and Auditors are re-appointed or the vacancies otherwise filled. The regulations for calling and conducting these meetings are contained in the company's Articles. These meetings are termed *Ordinary Meetings*, and the business transacted thereat is *Ordinary Business*. The Articles usually specify the business that is to be considered ordinary business. Business outside this specification is deemed to be *Special Business*, and in order to transact special business particulars of its nature must be given in the notice convening the meeting. Seven clear days' notice of ordinary meetings is usually required by the Articles to be given, and, generally, the notice must be accompanied by a copy of the annual accounts (except in the case of a private company, unless its Articles require accounts to be sent). Only shareholders, or their proxies (if the Articles so provide), are entitled to attend and vote. If default is made in calling this meeting, the Court may call it upon application of any member of the company. The majority of Articles provide that if the directors default in calling an annual general meeting two members may convene it. The auditor may attend if accounts which he has audited are to be laid before the meeting (S. 134 [3]).

Extraordinary General Meetings.—Meetings other than those described above are termed Extraordinary General Meetings. These may be called when desirable by the Directors, and must be called when requisitioned by the holders of not less than one-tenth of such of the paid-up capital of the company as at the date of the deposit of the requisition carries the right of voting at general meetings (S. 114). Where there are no special Articles to meet the case two or more members holding not less than one-tenth of the issued share capital can convene a meeting (S. 115). The Articles usually provide that all business transacted at an extraordinary meeting is to be deemed *special*, that full particulars of the business to be transacted must appear in the notice convening the meeting, and that no other business than that mentioned shall be transacted at the meeting. Debenture holders are not entitled to attend these meetings, neither, as a general rule under the Articles, are preference shareholders.

Company Resolutions.—Company resolutions are of three kinds: (*a*) Ordinary resolutions, (*b*) Extraordinary resolutions, (*c*) Special resolutions.

(*a*) *Ordinary Resolutions.*—These are resolutions passed on a show of hands or a poll by simple majority of those present, voting personally or by proxy, if the Articles allow of proxies. Such resolutions suffice for the ordinary business of an annual meeting, e.g. the adoption of the Report and Accounts, and declaration of dividend, election of Auditors, etc., and, subject to the Articles, for alterations of capital under S. 50 (*see* p. 270).

(*b*) *Extraordinary Resolutions.*—These are passed by a majority of not less than three-fourths of such members as, being entitled so to do, vote in person or, where proxies are allowed, by proxy, at a general meeting of which notice specifying the intention to propose the resolution as an extraordinary resolution has been duly given (S. 117 [1]). These resolutions are used for winding up an insolvent company voluntarily, to compromise with creditors in voluntary liquidation, and for other specified purposes.

(*c*) *Special Resolutions.*—These are passed by such a majority as is required for the passing of an extraordinary resolution at a general meeting of which not less than twenty-one days' notice, specifying the intention to propose the resolution as a special resolution, has been duly given. If all the members entitled to attend and vote at such a meeting so agree, however, a resolution may be proposed and passed as a special resolution at a meeting of which less than twenty-one days' notice has been given (S. 117 [2]). These resolutions are passed to alter the Articles; reduce paid-up capital (with consent of the Court); change the name of the company (with leave of the Board of Trade); wind up by the Court, and for many other purposes.

Printed copies of all extraordinary and special resolutions must

be filed with the Registrar within fifteen days of the date when they were passed (S. 118).

A declaration by the chairman of the meeting that a resolution has been carried is conclusive, unless the decision is challenged and a poll demanded (S. 117 [3]).

Poll.—A poll is an appeal to the general body of shareholders on some specified matter or proposal.

The regulations concerning the demand for, and conduct of, a poll are usually set forth in the Articles. Usually, a poll must be demanded by a stated number of members, say five. Under Table A, a poll may be demanded by three members, or by one or two members if that member or those two members together hold not less than 15 per cent. of the paid-up capital. If the Articles make no provision and Table A is excluded, it would appear that any shareholder may demand a poll. The chairman of the meeting at which a poll is demanded decides the date of the poll, and the manner of conducting it. Usually, sheets of foolscap are ruled with (1) a column for the signature of members, and (2) and (3) columns " For " and " Against " the resolution. Members record their votes by inserting in one of these columns the number of shares they hold. These sheets are checked with the Register of Members, and the result of the voting is afterwards announced by the chairman.

Voting.—The Articles of Association almost invariably define the voting power attached to a company's shares. If there are no regulations as to voting, Table A, unless expressly excluded, applies to companies registered since its promulgation. In the event of Table A being excluded, and no provision appearing in the Articles, each member has one vote in respect of each share or each ten pounds of stock held by him (S. 115 [1*f*]). Article 54 of revised Table A provides that every member shall have one vote on a show of hands, and on a poll one vote for every share held by him. The great majority of companies adopt similar regulations. Table A confers the right of a casting vote on the chairman of a meeting, but if Table A does not apply and the Articles are silent it would appear that no such right exists (*Nell* v. *Longbottom*, [1894] 1 Q.B. 767).

Proxies.—A shareholder may appoint a person to represent him at meetings, and practically to act as his agent. The word " proxy " is commonly applied both to the person appointed and to the instrument by which he is appointed. The Articles contain regulations as to proxies, and most Articles declare that persons appointed to act as proxies must themselves be members of the company, except in the case of proxies appointed to represent another company or corporation. Usually, proxies must be deposited forty-eight hours before the meeting at which they are to be used is held. It is usual to name three persons in the proxy form, in case one or other of the persons named is unable to attend the meeting. Proxies must bear a penny

stamp, if for use on one occasion only, but if the proxy is a *General Proxy* a ten-shilling stamp is required. Proxies must not be reckoned as part of a quorum.

Quorum.—A quorum is the minimum number of shareholders that must be present in order to constitute a meeting a valid meeting. The number fixed by most Articles is three, and this is also the quorum fixed by Table A (*Art.* 45). If Table A is excluded, the quorum for a private company is two members, any other company three members, personally present (S. 115 [1*d*]).

Inspection.—On the application of members holding not less than one-tenth of the shares issued (Banking Company one-third), the Board of Trade may appoint Inspectors to investigate and report upon the affairs of a company in such manner as the Board directs. Inspectors so appointed can examine the officers and agents of the company on oath. Refusal to yield up to the inspectors books, documents or information may result in the same penalties as contempt of court (S. 135). If from the Report the Board considers that any person has been guilty of a criminal offence against the company, the Board must refer the matter to the Director of Public Prosecutions (S. 136). A company may by special resolution appoint inspectors, who have the same powers and duties as those appointed by the Board of Trade, except that their report is made as directed by a general meeting (S. 137).

EXAMINATION QUESTIONS.

1. What particulars must the register of members of a company contain? What are the provisions of the Companies Act, 1929, with regard to (*a*) inspection, (*b*) obtaining copies of the register? (*Incorporated Accountants.*)

2. The officials of limited companies are under obligation to file certain returns with the Registrar of Joint Stock Companies. Are any of these returns of a financial nature? If so, briefly describe them. (*Royal Society Arts.*)

3. What statutory books are compulsory for use by a limited liability company? Give a short statement as to what is required to be entered in each book. (*Chartered Accountants.*)

4. What are the returns required under the Act to be filed at the office of the Registrar of Joint Stock Companies; and what other documents would you expect to find on the file? (*Chartered Accountants.*)

5. For what purposes are the following books kept, as applied to a limited company: (*a*) Allotment Book; (*b*) Register of Members; (*c*) Minute Book; (*d*) Register of Mortgages? (*Chartered Accountants.*)

6. Briefly describe the uses and contents of the undermentioned registers as employed by limited companies.

State the occasions, if any, upon which the auditor is concerned with them: (*a*) Register of Probates; (*b*) Register of Mortgages; (*c*) Register of Balance Certificates; (*d*) Register of Sealed Documents. (*Chartered Accountants.*)

7. Robert Coe, of Fairvale, Somerset, potato grower, applied on January 1, 19.., for 1,000 shares in the Erratic Motor Omnibus Company, Ltd., issued at par, paying 2s. per share on application.

These 1,000 shares were allotted to him on January 3, 19.., numbered 180365 to 181364, and he duly paid the allotment instalment of 8s. per share on January 4th.

On January 5th he bought a further 1,000 shares, 10s. paid, numbered 24062 to 25061 on the Stock Exchange at the price of 11s. per share, free of stamps and brokerage, the transfer for the same being lodged with the Company on January 5th, and approved by the Board the same day.

On January 16th he paid the first call of 10s. a share on his 2,000 shares, thus making them fully paid.

On February 5th he sold the whole of his holding on the Stock Exchange at 18s. per share, free of stamps and brokerage, the transfer being lodged with the Company and approved by the Board on February 10th.

Show a ruling of a Share Ledger and a Transfer Register for the Company, inserting in the latter the details of the foregoing transactions as far as they apply, and giving in the former R. Coe's account as a member of the Company. (*London Chamber Commerce.*)

8. On November 11th, J. B. Clark, of Altwood Road, Bray, applied for 1,000 £1 6 % Preference Shares in the Marne Mining Co., Ltd., and paid 2s. 6d. per share upon application. These shares were allotted to him by resolution of the Directors on November 16th, and were numbered 5490 to 6489. On November 18th he forwarded a cheque to the Company's Bankers for the amount due on allotment, viz. 5s. per share. On December 18th he paid to the Company's Bankers the first and final call of 12s. 6d. per share. On December 24th he sold 500 shares (numbered 5490 to 5989) at 25s. per share to A. Chatenay, The Chestnuts, Dover, the transfer for which was duly approved by the Directors on December 31st.

You are required to show the entries necessary to record these transactions in the statistical books of the Marne Mining Co., Ltd. (*Royal Society Arts.*)

9. State the various kinds of meetings of shareholders and the rules relating to each. (*Royal Society Arts.*)

10. What statutory obligations are imposed upon limited companies as regards the holding of General Meetings? What rights and remedies are given to shareholders in regard to the summoning of General Meetings? (*Chartered Accountants.*)

11. What provision is made by the Companies Act, 1929, with respect to the convening of Extraordinary General Meetings of a company on the requisition of shareholders? (*Chartered Accountants.*)

12. How and by whom may a General Meeting of a limited company be called, and what voting powers will its members have, where the Articles of Association of the company contain no provisions dealing with these matters? (*Chartered Accountants.*)

13. What powers has the chairman of a company meeting to adjourn the meeting? Can he be compelled to adjourn a meeting? (*Royal Society Arts.*)

14. State briefly the distinctions between an "ordinary," "extraordinary," and "special" resolution of a company. For what different purposes is a special resolution required by statute? (*Chartered Accountants.*)

15. Has an auditor the right of access to the Board Minute Book of a Company to which he has been appointed auditor? What are the provisions, if any, of the Companies Act of 1929 in regard thereto? (*Central Association Accountants.*)

16. Define a "special resolution," and give two instances where such a resolution would be necessary to authorise transactions you are asked to certify as auditor to a limited company. (*Chartered Accountants.*)

17. Distinguish between Ordinary and Extraordinary Meetings, referring especially to the business capable of being transacted at either. When can and must they be held? (*Chartered Institute Secretaries.*)

18. What is the Annual Return and of what does it consist? When must it be made, and wherein do the details required from a public differ from those required of private company?

19. In what ways are shares transferred? What is a blank transfer, and how can a lender who has taken a blank transfer as security protect himself against a subsequent fraudulent attempt to transfer the shares covered by the blank transfer?

20. Discuss the relative positions of a person who has taken a transfer of shares under a forged transfer (*a*) where the company, acting on the forged transfer, has issued a share certificate; (*b*) where it has not. What is the position of the true owner of the shares in either case?

21. What are Balance Tickets? Is any record made when these documents are issued?

22. Describe the process known as Certification of Transfers.

23. What is a Poll? What are the regulations governing the taking of Polls and how are they taken?

24. What are the voting powers of members of a company limited by shares? When does the Chairman of a company meeting have a casting vote? What is a Quorum?

25. Must a shareholder always vote in person at a company meeting? If not, in what other way may he record his vote? Give your answer in as full detail as you can. Describe in detail the posting of a Share Register.

26. What is a "Blank Transfer"? How can a loan creditor secure his position when holding a blank transfer?

27. The prospectus of the 5 % War Loan, 1929–47, announced that applicants were entitled to have their holdings allotted in any of the following forms: (*a*) Inscribed as Stock; (*b*) Registered as Stock; (*c*) Bonds to Bearer. Explain the meaning of these terms of issue, and describe the relative advantages and disadvantages of the three classes of security. (*Royal Society Arts.*)

28. Prepare "Statutory Report" from the following figures:—*Receipts:* On allotment of 50,000 shares of £10 each, £137,000. Proceeds sale of old building material removed from freehold, £1,742. Advanced on mortgage, £47,000. Received in respect of allotment of Debenture Stock (75 % of £100,000), £75,000. *Payments:* Purchase of freehold, £205,000. Paid builders on account, £12,600. Paid for Stock in Bond, £24,350. Paid salaries, £247. Office and petty expenses, £147. Preliminary expenses to date, £2,471. (*Chartered Accountants.*)

29. As the auditor of a limited company, you are asked to certify the Statutory Report. Upon attending at the company's office you are furnished with the under-mentioned particulars, which you are asked to assemble in the statutory form.

Submit the necessary statement in the form you would be prepared to certify, and append your certificate thereto.

The company was entitled to commence business on January 3, 19... The Nominal Capital is 100,000 Ordinary Shares of £1 each. The number of shares allotted is 72,865, of which (*a*) 40,000 were issued as fully paid to the vendor; (*b*) 10,000 were fully called and paid up; (*c*) of the balance of the issue, 10s. per share had been called and paid, except that the first call of 2s. 6d. per share on 200 shares remained unpaid.

£10,000 had been received in respect of a loan on mortgage of the company's works.

The payments were as follows: Vendor, balance of purchase price, £5,000; Preliminary Expenses, £1,250, (estimated in the prospectus at £1,000); Contractors on account of Freehold Factory, £6,850, less £750 allowed by them for old building material on site; Office Salaries, £722; Directors' Fees, £150; Incidental Expenses, £182. Date the report March 5, 19.., and fix a date for the statutory meeting. (*Chartered Accountants.*)

30. Criticise the following Balance Sheet attached to the Annual Return of a company submitted to you as auditor for signature, before being sent to Somerset House. To what date should such statement be made up? When may it be dispensed with?

BALANCE SHEET, JUNE 30, 19...

		£		£
To Share Capital issued— 100,000 Shares of £1 each		100,000	By Lands, Buildings, Plant, Goodwill and Trade Marks	120,000
" Debenture Stock		50,000	" Debtor Balances	30,000
" Credit Balances and Reserve Funds		25,000	" Stock	14,000
" Profit and Loss Account at June 30th	£2,500		" Cash at Bank and Sundry Investments	17,500
" Profit for year	9,000			
	11,500			
Less Dividend paid	5,000			
		6,500		
		£181,500		£181,500

(*Chartered Accountants.*)

31. Rule a specimen page for a "Register of Transfers" for a limited company, and illustrate its working by an example. (*Chartered Institute Secretaries.*)

Chapter XI

JOINT STOCK COMPANIES—*Continued*

Company Accountancy

[Note.—The references are to the *Companies Act*, 1929, unless otherwise stated.]

Opening Entries.—When the formalities incidental to the formation and registration of a company have been completed, the first task awaiting the company book-keeper will be to record the application for, and allotment of, shares, and the subsequent calls. The record of a share issue in its simplest possible form would be as follows :—

Illustration.—Dicksons, Ltd., offered 50,000 ordinary shares of £1 each for subscription at par, payable in full on application (January 1st). The exact amount of the issue was subscribed, allotted, and duly paid.

1 JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Jan. 1	Sundry Shareholders .. .. Dr.	P.L. 2	50,000	0	0			
	To Ordinary Share Capital Account	3				50,000	0	0
	For 50,000 Ordinary Shares applied for and allotted this day.							

1 CASH BOOK.

(Debit Side Only.)

		P.L.	£	s.	d.
19... Jan. 1	To Cash (Sundry Shareholders)	2	50,000	0	0

2 LEDGER. 2

SUNDRY SHAREHOLDERS.

Dr.		J.	£	s.	d.			C.B.	£	s.	d. Cr.
19... Jan 1	To Ordinary Share Capital	1	50,000	0	0	19... Jan. 1	By Cash	1	50,000	0	0

3 ORDINARY SHARE CAPITAL ACCOUNT. 3

Dr. Cr.

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 1	By Sundry Shareholders	1	50,000	0	0

Opening entries of so simple a character as those above are, however, improbable. A set of actual figures is therefore given below in order to carry the illustration further.

Illustration.—Uprichards, Ltd., offered the following for public subscription on January 1st :—

100,000 Ordinary Shares of £1 each.
20,000 8 % Preference Shares of £5 each.
1,000 5 % Debentures of £100 each.

The Ordinary Shares were payable :—

5s. per share on application.
5s. per share on allotment.
5s. per share one month after allotment.
5s. per share two months after allotment.

The 8 % Preference Shares were payable :—

20s. per share on application.
30s. per share on allotment.
50s. per share one month after allotment.

The Debentures were payable :—

£20 per debenture on application.
£30 per debenture on allotment.
£50 per debenture one month after allotment.

The subscription list was closed on January 1st with the following result :—

The whole of the Debentures and 18,000 Preference Shares were subscribed, and the Ordinary Shares were over-subscribed to the extent of 10,000 shares. The Directors went to allotment on January 5th, and letters of allotment and regret were posted on the same day, together with cheques for the deposits paid on the over-subscribed Ordinary Shares. The instalments were all paid on the due dates.

[Note.—For solution, *see* pp. 346–350.]

OPENING ENTRIES.

1

JOURNAL.

			Dr.			Cr.		
19...		L.F.	£	s.	d.	£	s.	d.
Jan. 5	Application and Allotment Account * (Ordinary Shares) . .. . Dr.	4	50,000	0	0			
	To Ordinary Share Capital Account	1				50,000	0	0
	Being 10s. per share (5s. on application and 5s. on allotment) on 100,000 Ordinary Shares of £1 each allotted as per resolution of Directors, dated January 5, 19 ..							
,, 5	Application and Allotment Account (8 % Preference Shares) .. .. Dr.	5	45,000	0	0			
	To Preference Share Capital Account	2				45,000	0	0
	Being 50s. per share (20s. on application and 30s. on allotment) on 18,000 Preference Shares of £5 each allotted as per resolution of Directors, dated January 5, 19...							
,, 5	Application and Allotment Account (5 % Debentures) .. .. Dr.	6	50,000	0	0			
	To Debentures Account	3				50,000	0	0
	Being £50 per debenture (£20 on application and £30 on allotment) on 1,000 Debentures of £100 each allotted as per resolution of Directors, dated January 5, 19...							
Feb. 5	First Call Account (Ordinary Shares) .. .. Dr.	7	25,000	0	0			
	To Ordinary Share Capital Account	1				25,000	0	0
	Being the first instalment of 5s. per share on 100,000 Ordinary Shares made pursuant to the conditions of issue.							
,, 5	First Call Account (Preference Shares) .. Dr.	8	45,000	0	0			
	To Preference Share Capital Account	2				45,000	0	0
	Being First and Final Call of 50s. per share on 18,000 Preference Shares made pursuant to the conditions of issue.							
,, 5	Call Account (5 % Debentures) .. .. .. Dr.	9	50,000	0	0			
	To Debentures Account	3				50,000	0	0
	Being the final instalment of £50 per debenture of £100 each pursuant to the conditions of issue.							
Mar. 5	Final Call Account (Ordinary Shares) .. Dr.	7	25,000	0	0			
	To Ordinary Share Capital Account	1				25,000	0	0
	Being the Final Call of 5s. per share on 100,000 Ordinary Shares of £1 each made pursuant to the conditions of issue.							

* Separate "Application" and "Allotment" Accounts are sometimes opened, but the combined account is more usual.

NOTE.—It has been stated in some text-books that these Journal entries are sometimes dispensed with, and the various capital accounts opened by direct posting from the Cash Book. The author has never seen or heard of such a practice, and the student will be wise to employ Journal entries as set out above.

CASH BOOK.

1 Dr. | Cr. 1

Date		L.F.	£	s.	d.	Date		L.F.	£	s.	d.
19... Jan. 1	To Sundry Persons. Amounts received on application, being 5s. per share on 110,000 Ordinary Shares applied for..	4	27,500	0	0	19... Jan. 5	By Sundry Persons. Amounts returned with letters of regret, being 5s. per share on 10,000 Ordinary Shares not allotted ..	4	2,500	0	0
" 1	" Sundry Persons. Amounts received on application, being 20s. per share on 18,000 Preference Shares applied for..	5	18,000	0	0						
" 1	" Sundry Persons. Amounts received on application, being £20 per debenture on 1,000 Debentures applied for	6	20,000	0	0						
5	" Sundry Persons. Amounts received on allotment, being 5s. per share on 100,000 Ordinary Shares allotted ..	4	25,000	0	0		Note.—In practice, the names, addresses, and other particulars relating to the various totals shown in this example would be set out in detail. A separate column would be kept for each class of share, or debenture, offered for subscription. If the issue were a large one, a separate Cash Book or loose Application and Allotment Sheets would be kept, and the totals only of the various columns would be carried to the Company's main Cash Book. This practice economises space and enables each instalment to be balanced with expedition. Usually debentures are payable in full on allotment.				
" 5	" Sundry Persons. Amounts received on allotment, being 30s. per share on 18,000 Preference Shares allotted ..	5	27,000	0	0						
" 5	" Sundry Persons. Amounts received on allotment, being £30 per debenture on 1,000 Debentures allotted	6	30,000	0	0						
Feb. 5	" Sundry Persons. Amounts received in respect of First Call of 5s. per share on 100,000 Ordinary Shares	7	25,000	0	0						
" 5	" Sundry Persons. Amounts received in respect of First and Final Call of 50s per share on 18,000 Preference Shares	8	45,000	0	0						
" 5	" Sundry Persons. Amounts received in respect of Final Call of £50 per debenture on 1,000 Debentures	9	50,000	0	0						
Mar. 5	" Sundry Persons. Amounts received in respect of Final Call of 5s. per share on 100,000 Ordinary Shares	7	25,000	0	0						

LEDGER.

1 Dr. ORDINARY SHARE CAPITAL ACCOUNT. Cr. 1

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 5	By Application and Allotment Account ..	1	50,000	0	0
						Feb. 5	„ First Call Account	1	25,000	0	0
						Mar. 5	„ Final Call Account	1	25,000	0	0
								£	100,000	0	0

2 Dr. 8 % PREFERENCE SHARE CAPITAL ACCOUNT. Cr. 2

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 5	By Application and Allotment Account ..	1	45,000	0	0
						Feb. 5	„ First and Final Call Account	1	45,000	0	0
									£90,000	0	0

3 Dr. 5 % DEBENTURES ACCOUNT. Cr. 3

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 5	By Application and Allotment Account ..	1	50,000	0	0
						Feb. 5	„ Call Account	1	50,000	0	0
								£	100,000	0	0

4 Dr. APPLICATION AND ALLOTMENT ACCOUNT (ORDINARY SHARES). Cr. 4

19...		C.B.	£	s.	d.	19...		C.B.	£	s.	d.
Jan. 5	To Ordinary Share Capital Account	1 J.	50,000	0	0	Jan. 1	By Cash— Sundry Persons on Application	1	27,500	0	0
„ 5	„ Cash— Sundry Persons (application money returned)	1	2,500	0	0	„ 5	„ Cash— Sundry Persons on Allotment	1	25,000	0	0
			£52,500	0	0				£52,500	0	0

LEDGER—*continued*.

APPLICATION AND ALLOTMENT ACCOUNT (8 % PREFERENCE SHARES).

5 DR. | CR. 5

Date	Dr.	J.	£	s.	d.	Date	Cr.	C.B.	£	s.	d.
19... Jan. 5	To Preference Share Capital Account	1	45,000	0	0	19... Jan. 1	By Cash— Sundry Persons on Application	1	18,000	0	0
						" 5	" Cash— Sundry Persons on Allotment	1	27,000	0	0
			£45,000	0	0				£45,000	0	0

APPLICATION AND ALLOTMENT ACCOUNT (5 % DEBENTURES).

6 DR. | CR. 6

Date	Dr.	J.	£	s.	d.	Date	Cr.	C.B.	£	s.	d.
19... Jan. 5	To Debentures Account..	1	50,000	0	0	19... Jan. 1	By Cash— Sundry Persons on Application	1	20,000	0	0
						" 5	" Cash— Sundry Persons on Allotment . ..	1	30,000	0	0
			£50,000	0	0				£50,000	0	0

CALL ACCOUNT (ORDINARY SHARES).

7 DR. | CR. 7

Date	Dr.	J	£	s.	d.	Date	Cr.	C.B.	£	s.	d.
19... Feb. 5	To Ordinary Share Capital Account (First Call)..	1	25,000	0	0	19... Feb. 5	By Cash— Sundry Persons (First Call)	1	25,000	0	0
Mar. 5	" Ordinary Share Capital Account (Final Call)..	1	25,000	0	0	Mar. 5	" Cash— Sundry Persons (Final Call)	2	25,000	0	0
			£50,000	0	0				£50,000	0	0

CALL ACCOUNT (8 % PREFERENCE SHARES).

DR. | CR. 8

Date	Dr.	J.	£	s.	d.	Date	Cr.	C.B.	£	s.	d.
19... Feb. 5	To Preference Share Capital Account (First and Final Call)	1	45,000	0	0	19... Feb. 5	By Cash— Sundry Persons (First and Final Call)..	2	45,000	0	0
			£45,000	0	0				£45,000	0	0

LEDGER—*continued.*

Call Account (5 % Debentures).

9 Dr.										Cr 9		
19... Feb. 5	To Debentures Account (Final Call)	J 1	£ 50,000	s. 0	d. 0	19... Feb. 5	By Cash— Sundry Persons (Final Call)	C.B. 2	£ 50,000	s. 0	d. 0
			£50,000	0	0				£50,000	0	0

Note.—In cases where more shares are applied for by an applicant than are allotted to him, the surplus application moneys are usually retained and applied in reduction of the amounts due on allotment. Letters of Regret are usually sent only to those applicants who receive no allotment. If separate Application and Allotment Accounts are opened, the above practice involves a transfer of the surplus so retained as follows :—

	£	s.	d.	£	s.	d.
Application Account (Ordinary Shares) Dr.	2,500	0	0			
To Allotment Account (Ordinary Shares)				2,500	0	0
Being transfer of application moneys, 5s. per share on 10,000 shares over-subscribed and now applied in payment (or part payment) of allotment moneys.						

BALANCE SHEET, MARCH 5, 19...

					£	s.	d.		£	s.	d.
Capital :—								Note.—The compensating "Asset" side entry may be "Cash at Bank" or in the form of property purchased, or taken over, from a vendor on the formation of the Company.			
Nominal :—											
100,000 Ordinary Shares of £1 each ..	£100,000	0	0								
20,000 8 % Preference Shares of £5 each	100,000	0	0								
	£200,000	0	0								
Issued :—											
100,000 Ordinary Shares of £1 each, fully paid	£100,000	0	0								
18,000 8 % Preference Shares of £5 each, fully paid	90,000	0	0								
					190,000	0	0				
5 % Debentures :—											
1,000 Debentures of £100 each, fully paid					100,000	0	0				

Issue of Shares at a Premium.—A limited company may issue *debentures* at par, i.e. at their exact nominal value, e.g. £100 per £100 debenture; or at a discount, e.g. £98 per £100 debenture; or at a premium, e.g. £102 per £100 debenture. But a limited company cannot legally issue its *shares* at a discount, i.e. for less than their nominal or face value (*Ooregum Gold Mining Co.* v. *Roper*, [1892]), except under S. 47 (see p. 303), neither can it purchase its own shares (*Trevor* v. *Whitworth*, [1888]). It may, however, issue shares at any premium which their popularity with the investing public can command. Thus, e.g., the unissued £1 shares of a company paying high dividends may be offered to the public at, say, 22s. 6d. or 25s., or more, per £1 share. The amount realised above the par value of the share is termed the *premium*.

Theoretically, the premium at which the shares are quoted represents the estimate made by the money market on the issuing company's ability to earn high profits in the future. This estimate is based partly on the amount of undistributed profits held by the company, and partly on the value of its goodwill. But there is always the possibility that, to an extent, the premium may be artificial owing to market operations.

When a company is so successful that it can command a premium on a new issue of shares, the purchasers of the new shares do, in fact, pay for admission to a share in the company's goodwill, as represented by its capacity to earn profits in excess of the normal rate. The new shareholders are very much in the position of an incoming partner who pays a premium for admission to an established business.

Usually, when a company's issued shares are quoted at a premium and it proceeds to a new issue of shares, the new capital is offered *pro rata* to the existing shareholders in priority to the general public. The Application and Allotment Sheets already described and illustrated (see p. 289) will serve equally well for an issue of shares at a premium, if a column is added to accommodate the amount of the premium due on each allotment. The Share Register needs no alteration, since no record of the premium paid on the shares is necessary, that Register being concerned only with the number and par value of the shares held by each member.

The premiums received on a share issue should be carried to a "Premiums on Ordinary (or Preference) Shares Account," and should be separately stated on the liability side of the Balance Sheet, as a capital reserve, and not merged in the general reserve. There would appear to be no legal obstacle to the employment of premiums received as ordinary revenue, unless such a procedure conflicts with the Articles of the company (*Re Hoare & Co.*, [1904]). It is urged, however, that premiums, being a capital profit, should be retained to meet capital losses, or to increase working capital, and not be treated as part of the profits available for the payment of dividends.

The entries required for an issue of shares at a premium are set out in the following illustration.

Illustration.—The nominal capital of Uprichards, Ltd., consisted of 200,000 ordinary shares of £1 each, of which 100,000 shares had been issued at par and fully paid up. Proving very successful, and needing additional working capital, the Company offered for public subscription on January 1st 50,000 ordinary shares of £1 each (being part of their unissued nominal capital) at the price of 30s. per share, payable as to 5s. per share on application, 20s. per share on allotment (including the premium of 10s. per share), and 5s. per share one month after allotment. The whole of the new issue was subscribed, and the Directors proceeded to allotment on January 6th. All allotment moneys were paid on January 8th, and all calls on February 6th.

ISSUE OF SHARES AT A PREMIUM.

1 JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
19... Jan. 6	Applications and Allotment Account .. .. Dr.	3	62,500	0	0			
	To Ordinary Share Capital Account	2				37,500	0	0
	,, Premiums on Ordinary Shares Account ..	5				25,000	0	0
	Being 5s. per share on application, and 20s. per share on allotment, including the premium of 10s. per share on 50,000 Ordinary Shares allotted as per resolution of Directors, dated January 6, 19...							
Feb. 6	Call Account .. .. Dr.	4	12,500	0	0			
	To Ordinary Share Capital Account	2				12,500	0	0
	Being 5s. per share on 50,000 Ordinary Shares of £1 each in respect of the First and Final instalments made as per conditions of issue and resolution of Directors, dated February 6, 19...							

(*Continued on pp.* 353–354.)

Issue of Shares at a Discount.—It is illegal to issue shares at a discount within one year after the company becomes entitled to commence business, but at any time thereafter, a general meeting may resolve that further shares of a class already issued shall be issued at a discount. The resolution must state the maximum discount and must be sanctioned by the court before being put into operation. The court may impose conditions, and the shares must be issued within one month after the court has given its sanction, unless the court allows a longer period (S. 47).

The powers thus given by the Act may be useful where a company requires further capital at a time when its shares are quoted below par, since the existing members or new subscribers naturally would not be willing to pay par for new shares under such circumstances but might be willing to subscribe at the market price, or at a price slightly below market price.

The entries for the issue of such shares are similar to those for the issue of any other shares, until the last call is made. It is submitted that the discount should not be credited to the members except

LEDGER.

1 Dr. ORDINARY SHARE CAPITAL ACCOUNT (ORIGINAL ISSUE). Cr. 1

			£	s	d	19...			£	s.	d
						Jan. 1	By Balance		100,000	0	0

2 Dr. ORDINARY SHARE CAPITAL ACCOUNT (NEW ISSUE). Cr 2

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 6	By Application and Allotment Account	1	37,500	0	0
						Feb. 6	„ Call Account (First and Final Call)	1	12,500	0	0
								£	50,000	0	0

3 Dr. APPLICATION AND ALLOTMENT ACCOUNT (ORDINARY SHARES NEW ISSUE). Cr. 3

19...		J.	£	s.	d.	19 ..		C.B	£	s.	d.
Jan. 6	To Ordinary Share Capital Account	1	37,500	0	0	Jan. 1	By Cash, Application Account	1	12,500	0	0
„ 6	„ Premium on Shares Account	1	25,000	0	0	„ 8	„ Cash, Allotment Account and Premium ..	1	50,000	0	0
		£	62,500	0	0			£	62,500	0	0

4 Dr. CALL ACCOUNT (NEW ISSUE). Cr. 4

19...		J.	£	s.	d.	19...		C B.	£	s.	d
Feb. 6	To Ordinary Share Capital Account	1	12,500	0	0	Feb. 6	By Cash (First and Final Call)	1	12,500	0	0

5 Dr. PREMIUM ON ORDINARY SHARES ACCOUNT. Cr 5

			£	s.	d.	19...			£	s.	d.
						Jan 6	By Application and Allotment Account		25,000	0	0

CASH BOOK.

2

Dr.			£	s.	d.				£	s.	d. Cr.
19.. Jan. 1	To Sundry Persons. Amounts received on application, being 5s. per share on 50,000 Ordinary Shares applied for ..	3	12,500	0	0						
,, 8	,, Sundry Persons. Amounts received on allotment, being 20s. per share (10s. on allotment and 10s. premium) on 50,000 Ordinary Shares allotted	3	50,000	0	0						
Feb. 6	,, Sundry Persons. Amounts received in respect of First and Final Call of 5s. per share on 50,000 Ordinary Shares	4	12,500	0	0						

BALANCE SHEET, FEBRUARY 6, 19..

(Debit Side Only.)

		£	s.	d		£ s. d.	£	s.	d.
Capital:—									
Nominal:—200,000 Ordinary Shares of £1 each	£200,000 0 0								
Issued:—100,000 Ordinary Shares of £1 each fully paid	100,000 0 0								
50,000 Ordinary Shares of £1 each (new issue) fully paid	50,000 0 0	150,000	0	0					
Premiums on Shares Account		25,000	0	0					

that an entry must be made debiting Discount on Shares Account and crediting Share Capital. It is submitted that this entry should be made preferably at the date of allotment so that a Balance Sheet drawn up after this date, but before further calls are made, would show as an asset so much of the discount as had not been written off.

The Journal Entry would be:—

		£	£
Discount on Shares Account	.. .. .. *Dr.*	500	
To Share Capital Account	.. ..		500
Discount of 5 *per cent. on issue of* 10,000 *shares of* £1 *each.*			

Calls.—Almost invariably the Prospectus specifies the dates on which calls become due. An interval of at least one month is usual between calls, but if a Stock Exchange quotation is desired for shares, two months must elapse between calls. Table A requires one month only. If calls are not regulated by the conditions of issue, the Directors can make calls at their discretion, but subject of course to any provisions contained in the company's Articles. The Directors must pass a resolution stating the amount of the call and its due date. In the event of liquidation, the Liquidator can (with the sanction of the Committee of Inspection, or of the Court) make a call immediately he is appointed. Sanction is not required in either a members' or a creditors' voluntary liquidation. A form of call notice is given on p. 293.

Calls are usually made payable direct to the company's bankers, and, in large issues, separate cash books and banking accounts are opened for each call. Differently coloured paper is used for each class of share. In due course, the call notices are collected from the bank and checked with the relative cash book and bank pass book or sheets. When the call is complete, the total of the call banking account is transferred to the company's main banking account. This practice facilitates checking, relieves the main cash book from a mass of detail, and provides a convenient medium for posting the Share Ledger. Specimen ruling for, and *pro-forma* entries in, a Subsidiary Cash Book are shown on p. 356.

Sometimes Call Books are kept, separate books being employed for each class of share. No Call Book is necessary for debentures, as these are almost invariably payable in full on allotment. Columns for calls are sometimes provided on the Application and Allotment Sheets, particularly where the due dates for instalments are stated in the prospectus. A suitable ruling for a Call Book is shown on p. 356.

Interest on Calls in Advance.—Shares in limited companies that are not fully paid are unpopular with the investing public—except, perhaps, banking shares. Usually, therefore, the full nominal amount of an issue of ordinary or preference shares is called up within two or

Rayon d'Or, Limited.

CALL BOOK.

Second and Final Call of 5*s*. per share on *100,000 Ordinary* Shares of £1 each.
Date Call made *July 4*, 19.., payable on or before *July 18*, 19...

No. of Call Letter.	Share Ledger Folio.	Shareholder. Name.	Shareholder. Address.	Shareholder. Description.	No. of Shares Held.	Amount of Call Due at 5s. £	s.	d.	Paid. C.B. Folio.	Paid. Date.	Paid. Amount. £	s.	d.	Outstanding. Amount. £	s.	d.	Outstanding. No. of Days	Outstanding. Interest Due. £	s.	d.	Remarks.
240	1/47	Ross, Robert	41 Greek St., Soho, W.	Merchant	400	100	0	0	321	19... Jan. 2	100	0	0								NOTE.—In this column will be noted any instructions received to apply to Bankers, or powers of attorney, etc, for further calls.
241	1/48	Chalmers, George	Maidenhead, Berks	Captain, D.S.O.	200	50	0	0	320	,, 1	50	0	0								
242	1/49	Cross, Mary	Park St., Southend	Miss	100	25	0	0	321	,, 2	25	0	0								
243	1/50	Ravary, Ann	16 Gloucester Terrace, W.	Mrs.	200	50	0	0	321	,, 2	50	0	0								

SUBSIDIARY CASH BOOK.

(CALLS.)

FIRST CALL 250,000 ORDINARY SHARES OF £1 EACH.

Date.	Name.	Address.	Call Book Folio.	Share Register Folio.	Amount. £	s.	d.	Total Transferred to General Cash Book. £	s.	d.	Cash Book Folio.	Remarks.
19... Jan. 6	Dickson, Hugh	Strabane, Ireland	641	224	100	0	0					
,, 6	Chatenay, Abel	5 Rue de la Paix, Paris	621	787	265	0	0					
,, 6	McArthur, George	Spencer House, London, E.C.	597	125	275	0	0					
,, 8	Pirrie, Lawrence	Altwood Road, Maidenhead	546	338	500	0	0					
								1,140	0	0	36	

three months of allotment. Where for any reason a proportion of the issued share capital remains uncalled, provision will be found in the majority of Articles, under power conferred by S. 48, ss. (2), to receive payment of calls in advance at a fixed rate of interest. The rates of interest payable, and the conditions under which they may be paid, have already been discussed on p. 295. The student must understand that calls paid in advance are in fact loans at interest to the company, the interest being payable although no profits are made by the company (*Lock* v. *Queensland Investment and Land Mortgage Co.*, [1896]). Separate Calls In Advance Accounts must be opened in the Ledger, and when a call is actually made, the Calls In Advance Account applicable to that particular call is closed by a transfer to Share Capital Account or Call Account as shown below. No entries are made in the Share Ledger until the call is due, and then the necessary credits are made in the accounts of those shareholders who have paid in advance.

DR. CALLS IN ADVANCE ACCOUNT. CR.

19...		L.F.	£	s.	d.	19...		C.B.	£	s	d.
June 1	To Share Capital Account	46	575	0	0		By Cash—				
						Feb. 8	J. R. Smith .	78	100	0	0
						" 10	W. White ..	81	50	0	0
						Mar. 9	B. Black ..	96	200	0	0
						" 10	R. Green ..	98	225	0	0
			£575	0	0				£575	0	0

The interest paid on calls in advance does not, of course, appear in the Share Ledger, the only entry necessary being as follows :—

JOURNAL.

19...		L.F.	£	s.	d.	£	s.	d.
July 31	Interest Account .. .. Dr.	49	124	7	6			
	To Sundry Shareholders (set out details)	127				124	7	6
	Being interest at 5 % for the half year on calls paid in advance.							

Income Tax at the Standard Rate in the £ is deducted from the interest, and a Journal entry is made, debiting the Sundry Shareholders' Account and crediting Income Tax Account, only the balance being paid in cash to the shareholders. When cheques for the interest due have been sent to the shareholders the Sundry Shareholders' Account will be closed, and the Interest Account will be transferred in due course to the Profit and Loss Account.

Interest on Calls in Arrear.—The majority of Articles reserve power to charge interest on calls in arrear. Table A fixes the rate at 5 %, but sometimes it is as high as 10 %. The total amount in arrear at any time is represented by the total of the debit balances of the

Allotment and Call Accounts. No entries are made in the Share Ledger. The only entry necessary is as follows :—

JOURNAL.

				Dr.			Cr.		
			L.F.	£	s.	d.	£	s.	d.
19... June 30	Sundry Shareholders (set out details) .. .. Dr.		92	38	9	6			
	To Interest Account		68				38	9	6
	Being interest to date at 6 % on calls in arrear.								

If, and when, the interest is paid, the Sundry Shareholders' Account will be automatically closed, and the Interest Account will be transferred in due course to the Profit and Loss Account. Experience proves that it is frequently unwise to take credit in the Profit and Loss Account for this interest until actually received.

Statement in Balance Sheet.—Calls in arrear, or paid in advance, are not extended as separate items in the Balance Sheet. Some examination candidates set out calls in arrear as an asset in the Balance Sheet. Although not incorrect in theory, this treatment is not met with in practice. The modern method illustrated below should be adopted in examination work.

Blanks, Limited.

BALANCE SHEET, DECEMBER 31, 19...

				£	s.	d.	£	s.	d.
Capital :—									
Nominal :—									
100,000 Ordinary Shares of £1 each				100,000	0	0			
100,000 6 % Preference Shares of £1 each				100,000	0	0			
£				200,000	0	0			
Issued :—									
100,000 Ordinary Shares of £1 each, 15s. per share called	£75,000	0	0						
Calls paid in advance	2,500	0	0						
				77,500	0	0			
100,000 6 % Preference Shares of £1 each fully called	£100,000	0	0						
Less Calls in arrear	2,000	0	0						
				98,000	0	0			
							175,500	0	0

Dividends.—When the profits of a limited company are divided amongst the proprietors (shareholders) the portion of such distribution received by each shareholder is termed a *dividend*. Almost invariably, companies frame special Articles governing the payment of dividends. These usually follow the Articles in Table A, which provides as follows : (1) Dividends are to be declared in general meeting, and no dividend may be declared exceeding the rate recommended by the Directors ;

(2) Interim dividends may be paid; (3) No dividend may be paid except out of profits; (4) Dividends may be paid only on the actual amounts paid up on the shares; (5) Calls paid in advance carry no right to dividend; (6) Directors may make such reserves as they deem proper prior to the declaration of a dividend. Where Table A is excluded, and no provision is made in the Articles for payment of dividends only on the actual amounts paid up on the shares, dividends are payable on the nominal value of the shares.

With the Balance Sheet and Profit and Loss Account (or Income and Expenditure Account, where applicable) the Directors must submit to the Annual General Meeting a report with respect to the state of the company's affairs, the amount, if any, which they recommend should be paid by way of dividend, and the amount, if any, which they propose to carry to the reserve fund, general reserve or reserve account which is, or is to be, shown specifically on the Balance Sheets of the company (S. 123 [2]). This report must be attached to every Balance Sheet issued.

Not infrequently, examination questions direct the candidate to provide for the preference dividend, and then to divide the final balance of profit they arrive at between the preference and ordinary (or preferred ordinary and ordinary) shares in given proportions. When the terms of the question also indicate that calls are in arrear, candidates appear to be uncertain whether to provide for the dividend on the nominal value of the shares, or the actual amount paid up on them. It is suggested that the better course to adopt is to assume that the dividend is paid on the called-up value of the shares, and that the dividends on such shares as are in arrear are impounded as against unpaid calls. In practice, this would probably be the course adopted, unless the Articles forbid it, or Table A has been adopted. A note should be made on the face of the accounts that this course has been followed.

Payment of Dividend out of Profits.—The question what constitutes the profits of a company available for dividend is so large and involved that it cannot be discussed in this work. Students are referred to the author's *Accounting*, pp. 320–9, where the question, "What is the profit of a company?" and the important legal decisions bearing upon the point are dealt with at length. The declaration that "no dividends shall be paid otherwise than out of profits" derives not alone from Table A. It is a fundamental principle of company law. Directors who pay dividends otherwise than out of profits, unless they are misled by *bona-fide* overvaluations or honest mistakes, or by the statements of responsible officials of the company whom they are entitled to trust, do so at their peril (*In re London and General Bank*, [1895]; *Dovey* v. *Cory*, [1901]), etc. The onus of proving that dividends have been paid out of profits is upon the Directors (*Rance's* case, [1871]).

The following brief summary of the rules laid down in the decided cases is all that is possible in this place, though the student will realise

that a decision of the judges is best understood when he has studied the full facts of the case :—

(*a*) To justify a dividend there must be a profit, but, so long as dividends are not paid out of capital, the Courts will not interfere with a proposed dividend, although the principle adopted for ascertaining profit may appear to be unsound.

(*b*) To divide the net income derived from a wasting property (e.g. a short leasehold) is not *illegal* if the Articles authorise it, although commercially unsound.

(*c*) Loss or depreciation of fixed capital does not prevent payment of a dividend, but loss of circulating capital must be made good before a dividend is paid.

(*d*) Realised accretions to capital may be brought into profit and loss account and dealt with accordingly, provided they remain after reviewing the accounts as a whole, and the company's Articles do not prohibit such treatment.

(*e*) Sums written off for depreciation, and profits written off against goodwill, may be applied as profits if in fact no depreciation has taken place.

(*f*) Profits carried to reserve are still profits unless capitalised. If capitalised on redemption of Redeemable Preference Shares, they remain capital and cannot at any time resume their revenue nature (*see* p. 301).

" Fixed capital," in the sense employed above, is property acquired and intended to be retained and used in the business with a view to earning profit, e.g. a factory, or machinery.

" Circulating capital " is property acquired or produced with a view to sale, e.g. the goods made in the factory

Directors' Report to Shareholders.—When profits are available for distribution as dividend, it is compulsory for the Directors to set out in their report to the shareholders a brief statement showing the amount available and their recommendations as to its disposal (*see* pp. 359 and 361).

It would appear necessary to report that no dividend is recommended where such is the case.

At the Annual General Meeting of the company convened to receive the Directors' Report and Accounts, the chairman, after explaining the accounts, proposes their adoption. When this motion has been considered and duly carried, a resolution is then submitted that a dividend at the specified rate or rates shall be paid on a named date. If this resolution is duly carried, the dividend becomes a debt due to the shareholders, but it carries no interest. Being specialty debts, claims to the payment of dividends are not barred until twenty years after they become due for payment (*Artisans' Land and Mortgage Corporation*, [1904]) and an entry in a Balance Sheet of debenture interest or

dividend unclaimed is a sufficient "acknowledgment" of the debt within the *Civil Procedure Act*, 1883, S. 5, and will prevent the claim being barred (*Burnham* v. *Atlantic and Pacific Fibre Importing and Manufacturing Co.* [1928]). Some companies take power in their Articles to forfeit unclaimed dividends within much shorter periods than twenty years (e.g. three years), but no quotation will be granted by the Stock Exchange where such powers exist.

The author has occasionally seen published accounts in which a proposed dividend appears as a debit in the Appropriation section of the Profit and Loss Account. Examination candidates are also prone to make such entries. This treatment is quite inaccurate. Until the dividend has been approved and passed by the shareholders in general

Illustration.

	£	s.	d.	£	s.	d.
The profit for the year, after making provision for Debenture Interest, Depreciation, and bad debts, amounts to				104,000	0	0
To which has to be added the balance brought forward from last year				24,000	0	0
				£128,000	0	0
From this must be deducted :—						
Transfer to Reserve Account	20,000	0	0			
Leasehold Redemption Fund	10,000	0	0			
Dividend on Preference Shares for the half-year to June 30th	10,000	0	0			
Interim Dividend on the Ordinary Shares paid on June 30th	10,000	0	0			
				50,000	0	0
Leaving an available balance of				£78,000	0	0
The Directors recommend the payment of :—						
Preference Dividend for the half-year to December 31st last	10,000	0	0			
Final Dividend of 15 % on the Ordinary Shares, free of tax, making 20 % for the year	30,000	0	0			
				40,000	0	0
Leaving a balance to be carried forward to next year of				£38,000	0	0

meeting, it is not a financial transaction that can be recorded in the books and accounts of the company. A dividend is not a debt until it has been duly declared (*In re Severn and Wye Railway Co.*, [1896]).

Preference Dividend Arrears.—It has already been stated that arrears of dividend on cumulative Preference Shares are a doubly *contingent liability* of the company, and as such should be noted on the face of the Balance Sheet, thus: "*Note.*—Arrears of dividend amounting to

£ . . . exist upon this Preference Capital." It has already been stated that if the available profits of any one year are insufficient to meet the preference dividends, they accumulate from year to year until sufficient profits have been earned to enable the arrears to be discharged. But since payment is contingent upon sufficient profits being earned, and dividends upon those profits being declared, the liability is not one that can be passed into the books. A note of its existence on the face of the Balance Sheet is all that is necessary. It is not necessary that a company should defer payment of its arrears of preference dividend until it is in a position to discharge the whole of the arrears. Instalments on account of such arrears are frequently paid. No dividends can be paid on the ordinary or other inferior classes of shares until all the arrears on the Cumulative Preference Shares have been discharged.

Interim Dividends.—Article 90 of Table A authorises Directors to pay such interim dividends as they deem to be justified by the profits of the company, and most companies, whether they do or do not adopt Table A, take power in their Articles to declare such dividends. Interim dividends are paid in anticipation of a final profit for the financial year, usually in respect of the first half of the financial year, and their payment does not require the sanction of a general meeting. Considerable responsibility attends the declaration of interim dividends, and the greatest care is necessary in preparing the interim accounts upon which the distribution is based. All necessary reserves, provisions, and depreciations should be made, and even then the distribution should be at a conservative rate. It would appear that directors are entitled to rely upon *bona-fide* valuations and opinions when estimating profits for the purpose of declaring an interim dividend (*Lucas* v. *Fitzgerald*, [1905]), but such dividends may be rescinded before payment (*Lagunas Nitrate Co.* v. *Schroeder*, [1901]), but no such power exists in respect of a final dividend once it has been declared (*Severn and Wye Railway Co.*, [1896]).

Book Entries.—When a dividend has been declared and duly passed the following entries are necessary :—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Feb. 3	Profit and Loss Account (Appropriation Section) .. Dr. To Dividend Account .. .. Being amount of dividend at 10 % on the 100,000 Ordinary Shares as per Shareholders' Resolution, January 30, 19. .							
,, 3	Dividend Account .. .. Dr To Income Tax Account .. .. Being tax at . . in the £ upon the dividends payable to the ordinary shareholders as above.							

The second Journal entry appearing above will not be necessary if the dividend is paid " free of tax."

The above Journal entries explain themselves. The first entry transfers the *gross* amount of the dividend from Profit and Loss to the credit of Dividend Account, and represents, in this case, a dividend of 10% on the total amount paid up on the ordinary share capital of the company. The company is entitled, however, to deduct income tax from each dividend paid, and the second Journal entry debits the Dividend Account with tax at the Standard Rate ruling at the date when the dividend is *payable*, irrespective of the Standard Rate ruling when the profits were earned, and credits a like amount to Income Tax Account. This credit represents the tax recoupable from the members on the profits distributed to them, and the fact that it is credited to Income Tax Account, to which the amount of tax actually payable to the Inland Revenue has been debited, thereby reduces the debit to Profit and Loss Account.

The company pays tax on its statutory profits, and is entitled to recoup tax at the full standard rate on such part of its profits as it distributes to the members.

Sometimes, instead of a debit direct to Profit and Loss Account, the following alternative entries are made.

JOURNAL.

			Dr.			Cr.		
		L.F.	£	s.	d.	£	s.	d.
19... Feb. 5	Dividend Account .. .. Dr. To Sundry Shareholders (Dividend, etc.) .. .. .. For dividend at 10 %, etc., etc.							
" 5	Sundry Shareholders .. .. Dr. To Income Tax Account .. .. Being tax at . . . . in the £, etc.							

In due course, when the Profit and Loss Account is being prepared, the Dividend Account is transferred to the debit of the Appropriation Section.

For the payment of dividends a separate banking account should be opened, and the net sum (i.e. the gross amount of the dividend less tax) should be transferred by the bank from the debit of the general banking account to the credit of the dividend banking account. Where shares of different classes are issued, this practice should be followed for each class of share. All dividend warrants presented for payment will be debited by the bank to this account, which will automatically close unless a balance remains thereon because some of the warrants have not been presented for payment. Any such balance will represent the amount of " unclaimed dividends."

Unclaimed Dividends.—When the warrants become "stale," the amount of the unclaimed dividends should be set out in the Balance Sheet as a separate liability. (See the *Burnham* case, however, on p. 361.) In some cases, a separate account is kept at the bank to which all unclaimed dividends are transferred. If no separate account is kept for this purpose, the balance of the Dividend Account will be transferred to the general banking account after a lapse of, say, three months. Old established companies frequently accumulate a considerable sum from unclaimed dividends.

Illustration.—Soleil d'Or, Ltd., published accounts for the year ended December 31, 19.., showing a net profit of £8,624. At the annual meeting on February 5th it was resolved to transfer £1,000 to Reserve Account, making that account £5,000 in all, to pay a dividend of 10 %, less tax, on the ordinary share capital of £50,000, and to carry forward the balance to next year. All dividend warrants were presented for payment as on March 1st, with the exception of a warrant for £100 (J. Smith), which was still outstanding. Assume Income Tax at 4s. in the £. Make the necessary entries to carry out the above resolutions.

36 JOURNAL.

			Dr.			Cr.		
		L F.	£	s.	d	£	s.	d.
19... Feb. 5	Profit and Loss Account (Appropriation Section) . Dr. To Dividend Account .. .. For dividend at 10 % on 50,000 Ordinary Shares of £1 each as per resolution.	41 81	5,000	0	0	5,000	0	0
„ 5	Dividend Account .. .. Dr. To Income Tax Account .. .. Being tax at 4s. in the £ on the above dividend.	81 37	1,000	0	0	1,000	0	0
„ 5	Profit and Loss Account (Appropriation Section) .. Dr. To Reserve Account .. .. Transfer to the latter Account as per resolution.	41 105	1,000	0	0	1,000	0	0

41 PROFIT AND LOSS ACCOUNT. 41

Dr.										£	s.	d.
19...		J.	£	s.	d.	19...						Cr.
Feb. 5	To Dividend Account	36	5,000	0	0	Dec. 31	By Balance brought down	√		8,624	0	0
„ 5	„ Reserve Account	36	1,000	0	0							
„ 5	„ Balance carried down	√	2,624	0	0							
		£	8,624	0	0				£	8,624	0	0
						19... Feb. 5	By Balance brought down	√		2,624	0	0

81 DIVIDEND ACCOUNT. **81**

Dr. Cr.

		J.	£	s.	d.			J.	£	s.	d.
19... Feb. 5	To Income Tax Account	36	1,000	0	0	19... Feb. 5	By Profit and Loss Account	36	5,000	0	0
Mar. 1	,, Cash	93	3,900	0	0						
,, 1	,, Balance carried down	√	100	0	0						
		£	5,000	0	0			£	5,000	0	0
						19 .. Mar. 1	By Balance brought down (J. Smith unclaimed)	√	100	0	0

93 CASH BOOK. **93**

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Mar. 1	By Sundry Dividend Warrants presented to date	81	3,900	0	0

Note.—In practice, this amount would have been arrived at by the transfer to Dividend Banking Account of £4,000, and the return, on March 1st, of £100 unclaimed at that date, the two entries (debit and credit) in the Cash Book resulting in the above balance of £3,900.

37 INCOME TAX ACCOUNT. **37**

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
						19... Feb 5	By Dividend Account	36	1,000	0	0

105 RESERVE ACCOUNT. **105**

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
						19... Dec. 31	By Balance brought forward	√	4,000	0	0
						Feb. 5	,, Profit and Loss Account	36	1,000	0	0
								£	5,000	0	0

Income Tax on Dividends.—It will be clear to the student that companies *must* deduct tax from Preference or other dividends of *fixed* amount, otherwise the preferential rate of dividend will be exceeded to the detriment of the ordinary shareholders. A fixed preference dividend of 8% paid "free of tax" would in effect amount to a dividend of 10%, assuming the tax to be 4s. in the £. Dividends on ordinary shares are in a different category, and companies, if they so desire, may elect to send out the warrants as "tax free." This expression is not, however, a happy one. No dividend is free from the obligation of income tax. The effect of paying a dividend "free of tax" is simply to increase the rate of dividend by the amount of tax at current rates.

Reference to the specimen dividend warrant given on p. 371 will show that the gross amount of the dividend, the amount of the tax deducted, and the net amount of the warrant are clearly stated in accordance with S. 33, *Finance Act*, 1924, and the present regulations of the Inland Revenue Authorities. The warrant also certifies the due payment of the tax, and is accepted by the Authorities in support of claims for repayment of income tax or relief. The amount of tax deducted from dividends is not remitted to the Inland Revenue Authorities, but stands, as shown above, as a credit to Income Tax Account, to which will be debited the total tax payable by the company when its assessment to income tax for the year is settled.

EXAMINATION QUESTION.

The capital of Christines, Ltd., consisted of £100,000, divided into 40,000 8 % Preference Shares of £1 each and 60,000 Ordinary Shares of £1 each. The whole of this capital was fully paid up.

The profits of the company for the year ended December 31, 19... amounted to £18,782.

The Directors decided to allocate this profit as follows :—

(*a*) To pay the Preference Dividend due for the year.
(*b*) To pay a dividend of 10 %, free of tax, on the Ordinary Shares.
(*c*) To open a Reserve Account and transfer £5,000 thereto.
(*d*) To carry forward the balance to next year.

Give the entries necessary to record this decision in the books of the company. (*Royal Society Arts.*)

Solution.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

(APPROPRIATION SECTION.)

Dr.				£	s.	d.		Cr.		£	s.	d.
19... Dec. 31	To 8 % Preference Dividend Account	6		3,200	0	0	19... Dec. 31	By Balance brought down	√	18,782	0	0
" 31	" Ordinary Dividend Account ..	4		6,000	0	0						
" 31	" Transfer to Reserve Account ..	8		5,000	0	0						
" 31	" Balance carried down	√		4,582	0	0						
			£	18,782	0	0			£	18,782	0	0
							19... Dec. 31	By Balance brought down	√	4,582	0	0

NOTE.—A proper reserve should have been made for the income tax liability, less the amount recoupable from the preference shareholders, before declaring a "free of tax" dividend on the ordinary shares. It is assumed that this has been done, although no credit on income tax account is mentioned in the question.

recommend a "free of tax" dividend at the rate of 10 % per annum on the Ordinary Share capital for the year ended June 30, 19.., to be satisfied by the distribution among the shareholders of part of its investment in Soleil d'Or, Ltd., at par. The shareholders duly declared the dividend at the annual general meeting, and the distribution took place on October 1 19... (*a*) Show by means of Journal entries the necessary entries in the books of Rayon d'Or, Ltd. (*b*) Would any entries be necessary in the books of Soleil d'Or, Ltd.?

Rayon d'Or, Limited.

BALANCE SHEET, JUNE 30, 19..

	£	s.	d.		£	s.	d.
Issued Capital:—				*Sundry Assets*	110,500	0	0
10,000 7 % Preference Shares of £1 each, fully paid ..	10,000	0	0	*Investment* in 20,000 Shares of £1 each, fully paid, in Soleil d'Or, Ltd., at cost	19,500	0	0
40,000 Ordinary Shares of £2 each, fully paid	80,000	0	0				
Sundry liabilities	40,000	0	0				
£	130,000	0	0	£	130,000	0	0

(*a*) **Rayon d'Or, Limited.**

JOURNAL.

			Dr £	s.	d.	Cr £	s.	d.
19... Oct. 1	Profit and Loss Account (Appropriation Section) .. Dr.		8,000	0	0			
	To Ordinary Dividend Account					8,000	0	0
	Being dividend at the rate of 10 % per annum "free of tax" declared this day.							
,, 1	Ordinary Dividend Account .. .. Dr.		8,000	0	0			
	To Investment in Soleil d'Or, Ltd.					8,000	0	0
	Being satisfaction of Dividend by the transfer of 8,000 shares of £1 each, fully paid, at par, in Soleil d'Or, Ltd.							

NOTES.—(1) It is assumed that Income Tax has been reserved for in full.

(2) The difference between the par and book values (£200) of the shares transferred may be credited to a Capital Reserve, but it is more prudent to retain it in the Investment Account until it is seen what the remaining shares realise.

(*b*) The transfers would go before the Directors of Soleil d'Or, Ltd., in the usual way, and the necessary entries made in the Register of Members. No other entries would be required, unless a Register of Transfers had to be written up.

Dividend Book or Sheets.—It is usual and useful to prepare a set of ruled sheets to record the details of the payment of a dividend, or to keep a conveniently ruled book to record details of a series of dividends. The ruling of such a book will be found on p. 370.

Dividend Warrants.—The instrument by means of which the payment of dividends is effected is called a Dividend Warrant. Specimens of such documents, reproduced from an Inland Revenue circular, are given on p. 371.

These warrants serve several purposes. They provide: (*a*) notice

and particulars of the dividend payable to the shareholder; (*b*) a certificate of the amount deducted for income tax; (*c*) a cheque in payment of the amount due. The lower portion of the warrant is paid into the payee's bank, the upper part being retained by him. The payee's signature on the face of the cheque instead of the usual indorsement facilitates rapid reference when the warrants are filed, and is convenient for audit purposes. S. 33 of the *Finance Act*, 1924, requires every warrant to show: (*a*) the gross amount which after deduction of tax corresponds to the net amount actually paid; (*b*) the rate and the amount of tax appropriate to such gross amount; (*c*) the net amount paid. Failure to comply with these requirements renders defaulters liable to a fine.

Payment of Dividends Direct to Banker.—It is a growing and useful practice for shareholders to instruct the companies to pay dividends direct to their bankers. Most companies welcome this practice, and, on request, will supply printed forms containing the necessary instructions to be filled in, signed, and returned by the shareholder. Warrants drawn under such authority are made payable, e.g., to "The National Provincial Bank Limited for the account of ....," and are acknowledged by the bank to the companies, they being authorised to accept the bank's receipt as a full discharge. When a number of instructions are received to pay dividends to various accounts at the same bank, it is customary to send one cheque only to the bank covering all dividends due, accompanied by the individual counterpart warrants. This practice saves time and stamp duty. The companies should make a note in their Share Registers, and Dividend Books, if kept, of the receipt of all such instructions.

Closing the Register.—The student may have seen in the public Press, under the headings of the companies concerned, notices to the following effect: "Blanks, Limited. Notice is hereby given that the registers of all classes of shares in the above company will be closed from February 1 to February 14, 19.., both days included." Such a notice means that no transfers of shares will be registered by the company during the fourteen days indicated, the registers being closed for the purpose of preparing dividend lists for the shares as registered on February 1st. Persons buying or selling shares between these dates must settle the ownership of the dividend about to be declared on them as between themselves. If the shares are sold *cum div.*, the purchase price of the shares will be increased by the amount of the dividend, and the dividend will belong to the purchaser; if they are sold *ex div.*, the dividend will belong to the seller. The company will pay the dividend to the registered holder of the shares at the date when the register was closed, and if the shares have been sold *cum div.*, the buyer will claim the amount from the seller. Closure usually takes place immediately prior to the annual general meeting and lasts for fourteen days. Normally, quoted shares are made *ex div* on the Stock Exchange Account

Rayon d'Or, Limited.

DIVIDEND SHEET.

(ORDINARY SHARES.)

Dividend at 5 % per annum payable on the 15th day of March, 19.., in respect of the year ended December 31, 19...

Folio Share Register.	No. of Dividend Warrant.	Payees.		Payee's Holding.	Dividend at .. %.			Income Tax Deducted at .. in the £.			Net Amount of Warrant.			Date Cleared at Bank.	Remarks.
		Name.	Address.												
					£	s.	d.	£	s.	d.	£	s.	d.		When directions are received to pay dividends to shareholders' Bankers, notes are made here of the Banks in question. Sometimes a special column is employed for this purpose.

NOTE.—Separate Dividend Sheets should be employed for each class of share in respect of which dividends are paid. When complete, the loose sheets should be bound in book form.

Example (1).

(Form for Dividend "Less Income Tax.")

The X Y Z Company, Limited.

127 Concord House,
London, E.C. 2.

No. 7641. *December* 1, 19...

To *James Scott.*

A dividend at the rate of 5 % *per annum* on the *Ordinary* Shares of the Company having been duly declared for the *year* ended *September* 30, 19.., I beg to forward you the annexed warrant for the amount in respect of the shares registered in your name.

		£	s.	d.
1,200 *Ordinary* Shares of £1 each at 5 %	=	60	0	0
Less Income Tax at 4s. 0d. in the £	=	12	0	0
Net amount of Warrant		£48	0	0

I hereby certify that Income Tax on the profits of the Company, of which profits this dividend forms a portion, has been or will be duly paid to the proper Officer for the receipt of Taxes.

J. GRANT, *Secretary*

This portion of the sheet should be preserved, as it will be accepted by the Inland Revenue authorities in connection with any claim to allowance or relief from Income Tax.

Example (2).

(Form for Dividend "Free of Income Tax.")

The X Y Z Company, Limited.

127 Concord House,
London, E.C. 2.

No. 7641. *December* 1, 19...

To *James Scott.*

A dividend at the rate of 5 % *per annum*, "free of Income Tax," on the *Ordinary* Shares of the Company having been duly declared for the *year* ended *September* 30, 19.., I beg to forward you the annexed warrant for the amount in respect of the shares registered in your name.

1,200 *Ordinary Shares* of £1 *each* at 5 % .. .. = £60 0 0

	£	s.	d.
This dividend is equivalent to a gross amount of ..	75	0	0
Less Income Tax at 4s. 0d. in the £	15	0	0
Net amount of Warrant	£60	0	0

I hereby certify that Income Tax on the profits of the Company, of which profits this dividend forms a portion, has been or will be duly paid to the proper Officer for the receipt of Taxes.

J. GRANT, *Secretary.*

This portion of the sheet should be preserved, as it will be accepted by the Inland Revenue authorities in connection with any claim to allowance or relief from Income Tax.

day following the declaration of the dividend, provided the Transfer Books have already been closed. If the Transfer Books are not closed until after the dividend has been declared, the securities are made *ex div.* on the account-day following the closing of the Books.

Stale and Lost Warrants.—Dividend warrants usually bear a note to the effect that payment will be refused unless they are presented within six months of the date of issue. A stale warrant unpresented, or presented and refused, may be submitted to the secretary of the issuing company, for verification, and may be presented or re-presented for payment on his authority. Usually, this authorisation is in the form of an indorsement of the warrant:—

Please Pay

BLANKS, LTD.,

GEORGE WILLIAMS,

26/10/19... *Secretary.*

If a warrant is reported lost, the company will issue a duplicate, provided that it is indemnified against loss by the shareholder.

Dividends on Bearer Securities.—It has already been explained that bearer securities are usually accompanied by a sheet of coupons which entitle the bearer to payment of the specified interest on the dates named thereon. Listing forms can be obtained from the company, and must usually be prepared and handed, with the coupons, to the holder's banker, who will collect the dividend due as if he were collecting a cheque, tax being deducted at the standard rate. If no coupons are issued, the holder of a share warrant must deposit it with the secretary for verification. If in order, the warrant will be returned to him together with a cheque for the amount due, *less* tax.

Dividend Reserve Account.—Some companies maintain such an account for the purpose of equalising dividends as between lean and prosperous years. Such a reserve is useful in the case of companies whose profits fluctuate widely, and tends to steady the market price of the shares. To fulfil its purpose satisfactorily, a fund of this kind should be invested outside the business in sound securities.

Bonus Shares as Dividend.—A successful company may have accumulated a large reserve account out of profits. The expansion of the company has necessitated increased working capital, and, to obtain this, the company has retained profits in the business instead of distributing them " up to the hilt." In these circumstances, the market value of the shares is sure to appreciate, and the premium may become so high as gravely to restrict the market for the shares. For these, and other financial reasons, a distribution of part, or of the whole, of the

accumulated reserve may be desirable. Such a distribution will be *intra vires* if the Articles of the company give power to issue "bonus shares." The procedure adopted is to transfer such part of the reserve as may be necessary to the credit of Profit and Loss Account, or Bonus Dividend Account, and to declare a dividend payable in fully paid shares instead of in cash. Generally an agreement is entered into by the company with X on behalf of the shareholders providing for payment not in cash but in shares; and this agreement is approved by the company in general meeting. Recipients of dividends taking the form of bonus shares are not liable to sur-tax in respect thereof, unless the distribution includes such an option to take either shares or cash as to constitute it income. Recent cases indicate that the decision of the company as to whether the distribution is capital or income holds good, provided the decision is supported by the facts. The shares have already, of course, paid income tax, since the reserve has been accumulated out of profits on which the company was assessed in the usual course. As to the capitalisation of profits on redemption of redeemable preference shares, see pp. 301 and 385.

Financial companies, sometimes, also distribute shares they have acquired in the course of flotations, or other transactions, amongst their shareholders in the form of dividends payable in kind. Again, companies in need of further working capital may secure the capital by declaring a dividend payable in shares, the necessary funds being provided out of profits. Further, shares not fully called may be called up as to the balance, the necessary funds being provided by a distribution from reserve.

Illustration 1.—Soleil d'Or, Ltd., was registered with a nominal capital of £100,000 in shares of £1 each. £75,000 of this capital was issued, subscribed, and fully paid. The Company proved prosperous, and, on December 31, 19.., had accumulated a Reserve Fund of £55,000. On the same date it was resolved to distribute a portion of the Reserve Fund and to declare a bonus dividend in the shape of an issue of one fully paid share of £1 to every two shares held. The entries are as follows:—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Reserve Fund .. .. Dr.	1	37,500	0	0			
	To Bonus Dividend Account..	5				37,500	0	0
	Being transfer from Reserve to provide for the Bonus distribution passed this day.							
" 31	Bonus Dividend Account .. .. Dr.	5	37,500	0	0			
	To Ordinary Share Capital Account	3				37,500	0	0
	Being the issue of 37,500 new Ordinary Shares in accordance with the terms of the resolution, dated December 31, 19...							

1 RESERVE FUND. 1

Dr.		J.	£	s.	d.		Cr.		£	s.	d.
19... Dec. 31	To Bonus Dividend Account	7	37,500	0	0	19... Dec. 31	By Balance	√	55,000	0	0
" 31	" Balance carried down	√	17,500	0	0						
		£	55,000	0	0			£	55,000	0	0
						19... Dec 31	By Balance brought down	√	17,500	0	0

3 ORDINARY SHARE CAPITAL ACCOUNT. 3

Dr.			£	s.	d.		Cr.		£	s.	d.
						19... Dec. 31	By Balance	√	75,000	0	0
						" 31	" Bonus Dividend Account	J.7	37,500	0	0
								£	112,500	0	0

Note.—The Company would have to increase its Capital to the required amount before the distribution could be made.

5 BONUS DIVIDEND ACCOUNT. 5

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Ordinary Share Capital Account	7	37,500	0	0	19... Dec. 31	By Reserve Fund..	7	37,500	0	0
		£	37,500	0	0			£	37,500	0	0

Alternative entries are as follows :—

Reserve Account .. .. .. Dr.
To Profit and Loss Account ..

Profit and Loss Account .. .. Dr.
To Sundry Shareholders .. ..

Sundry Shareholders .. .. Dr.
To Share Capital Account .. ..

If the shares of the Company are not fully paid, and the Bonus is to be utilised to meet a final call of 5s. per share, instead of calling upon the shareholders to find the cash, the entries would be :—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	*Final Call Account .. .. Dr.*		25,000	0	0			
	To Share Capital Account					25,000	0	0
	Being Final Call of 5s. per share on 100,000 shares made this day.							
" 31	*Sundry Shareholders .. .. Dr.*		25,000	0	0			
	To Final Call Account					25,000	0	0
	Being call of 5s. per share due this day.							
" 31	*Reserve Account .. .. Dr.*		25,000	0	0			
	To Sundry Shareholders					25,000	0	0
	Being Bonus declared this day.							

If the Company so elects, the Bonus Shares may be issued at a premium; in which case the entry would be :—

Profit and Loss Account .. .. *Dr.*
To Sundry Shareholders .. ..
,, *Premiums on Shares Account* ..

Or, alternatively, as shown in the illustration on p. 352.

Illustration 2.—Rayon d'Or, Ltd., was registered with a nominal capital of £200,000 in shares of £1 each. 100,000 of these shares were issued, subscribed, and fully paid up. On December 31, 19.., the market quotation for the shares was $2\frac{1}{4}$–$2\frac{3}{8}$.

The directors decided to declare a dividend payable by the issue of one £1 share, taken at the price of £2, for every fifty £1 shares held. The necessary funds were to be provided out of profits, the credit balance of the Profit and Loss Account being £10,286.

The necessary entries are :—

JOURNAL. 9

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Profit and Loss Account .. .. Dr.	3	4,000	0	0			
	To Bonus Dividend Account	5				4,000	0	0
	Being transfer of funds to provide for the issue of 2,000 new £1 shares at £2 each as per resolution this day.							
,, 31	Bonus Dividend Account .. .. Dr.	5	4,000	0	0			
	To Sundries :—							
	Share Capital Account	1				2,000	0	0
	Premium on Shares Account..	7				2,000	0	0
	Being transfers recording the issue of 2,000 new shares and the premium of £1 per share.							

1 SHARE CAPITAL ACCOUNT. 1

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance	√	100,000	0	0
						,, 31	,, Bonus Dividend Account	J. 9	2,000	0	0
								£	102,000	0	0

3 PROFIT AND LOSS ACCOUNT. 3

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Bonus Dividend Account	9	4,000	0	0	19... Dec. 31	By Balance.. ..	√	10,286	0	0
,, 31	,, Balance carried down	√	6,286	0	0						
		£	10,286	0	0			£	10,286	0	0
						19.. Dec. 31	By Balance brought down	√	6,286	0	0

5 BONUS DIVIDEND ACCOUNT. 5

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Share Capital Account	9	2,000	0	0	19 .. Dec. 31	By Profit and Loss Account	9	4,000	0	0
" 31	" Premium on Shares Account	9	2,000	0	0						
		£	4,000	0	0			£	4,000	0	0

7 PREMIUM ON SHARES ACCOUNT. 7

Dr.				s.	d.		Cr.	J.	£	s.	d.
						19... Dec. 31	By Bonus Dividend Account	9	2,000	0	0

Illustration 3.—Assume that the bonus distribution is made to meet payment of the uncalled portion of the share capital. The entries in this case are exactly on the lines of those illustrated in (2) above. The Reserve Fund, or Profit and Loss Account, as the case may be, is debited with the amount necessary to meet the call, and the Bonus Dividend Account is credited with a similar amount. The Bonus Dividend Account is then debited, and Final Call Account credited, with the same amount. This entry completes the payment in full of the shares. Final Call Account is closed by transfer to the credit of Share Capital Account.

EXAMINATION QUESTION.

The Annual Accounts of Rayon d'Or, Ltd., showed a balance to the credit of Profit and Loss Account of £5,950 as on December 31, 19... The Nominal Capital of the Company consisted of 10,000 shares of £1 each, all of which had been subscribed and fully paid up.

At the Annual Meeting in February 19.. it was decided: (*a*) To increase the Nominal Capital of the Company to £15,000 by the issue of 5,000 6 % Preference Shares of £1 each. (*b*) To pay a dividend for the year 19.. of 55 %, 50 % to be discharged by the issue of fully paid Preference Shares at par, and the balance 5 % to be paid in cash.

Give the entries necessary to record these transactions. (*Royal Society Arts*.)

Solution.

Rayon d'Or, Limited.

1 PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19... 1

(Appropriation Section.)

Dr.			£	s.	d.		Cr.		£	s.	d.
19... Feb. 28	To Ordinary Share Dividend .. .	3	5,500	0	0	19... Dec. 31	By Balance brought down	√	5,950	0	0
" 28	" Balance carried down	√	450	0	0						
		£	5,950	0	0			£	5,950	0	0
						19... Feb. 28	By Balance brought down	√	450	0	0

3 ORDINARY SHARE DIVIDEND ACCOUNT. 3

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Feb. 28	To Preference Share Capital Account	9	5,000	0	0	19... Feb. 28	By Profit and Loss Account	1	5,500	0	0
„ 28	„ Cash	C.B. 8	400	0	0						
„ 28	„ Transfer to Income Tax Account	11	100	0	0						
		£	5,500	0	0			£	5,500	0	0

Note.—Income Tax is assumed to be 4s. in the £.

ORDINARY SHARE CAPITAL ACCOUNT. 5

Dr. Cr.

			£	s.	d				£	s.	d.
						19... Dec 31	By Balance	√	10,000	0	0

7 CASH BOOK. 7

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Feb. 28	By Sundry Shareholders. Dividend at 5 %, less tax at 4s. in the £ ..	3	400	0	0

9 6 % PREFERENCE SHARE CAPITAL ACCOUNT. 9

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Feb. 28	By Transfer from Dividend Account	3	5,000	0	0

11 INCOME TAX ACCOUNT. 11

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Feb. 28	By Dividend Account	3	100	0	0

The above entries are frequently the only ones made in actual practice. In the author's opinion, such transactions should be journalised to secure a sequential record. The examination candidate may answer questions of this type by submitting either Journal or Ledger entries—both cannot fairly be expected in a speed test. The Journal entries are set out below, and would gain equal marks.

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Profit and Loss Account (Appropriation Section) .. Dr. To Ordinary Share Dividend Account .. .. Being dividend at 55 % on 10,000 Ordinary Shares of £1 each.	5,500	0	0	5,500	0	0
" 31	Ordinary Share Dividend Account .. .. Dr. To 6 % Preference Share Capital Account .. .. .. Being dividend at 50 % satisfied by the issue, as fully paid, of 5,000 6 % Preference Shares of £1 each.	5,000	0	0	5,000	0	0
" 31	Ordinary Share Dividend Account .. .. Dr. To Cash (Bank) .. .. Being dividend of 5 % payable in cash less tax at 4s. in the £	400	0	0	400	0	0
" 31	Ordinary Share Dividend Account .. .. Dr. To Income Tax Account .. .. Being income tax at 4s. in the £ deducted from the above dividend.	100	0	0	100	0	0

Forfeiture and Re-issue of Shares.—Companies have no statutory right to forfeit shares. The Act is silent on the matter, but provision is made in the statutory form of the Annual Return for details of any shares forfeited. Power to forfeit shares should be taken in the Articles. Practically, all companies take this power, and their Articles regulating forfeiture follow in the main those of Table A. If a company's Articles are silent on the subject of forfeiture, and Table A is not excluded, Articles 23–29 of Table A apply automatically.

The usual procedure is to send a formal notice to the member whose calls are in arrear requesting payment, reminding him that interest will be charged on the unpaid calls, and that, if the notice is not complied with, the shares are liable to forfeiture. If this notice fails, it is followed by a second demanding payment of the calls and interest thereon, and intimating that, in the event of non-compliance, the shares will be forfeited on a date not less than fourteen days from the date of the notice. Both these notices are sent by registered post. Should the second notice prove ineffectual, a resolution is then passed by the Directors forfeiting the shares, and notice of the fact is sent to the shareholder. Departure from the procedure laid down in the case of forfeiture may invalidate the forfeiture. The procedure must be exactly pursued, and every condition precedent complied with. "A very little inaccuracy is as fatal as the greatest" (James, L.J., *Johnson* v. *Lyttle's Iron Agency*, [1877]).

Some students appear to think that when shares are forfeited they are cancelled. This, of course, is not the case, since such a proceeding would amount to a reduction of capital, which can only be effected by leave of the Court. Forfeited shares become the property of the company, and may be re-issued at any price which, together with the amount paid on them by the original holder, will produce 20s. in the

£. Thus, if X. Y. was allotted 100 £1 shares in Blanks, Ltd., and had paid 10s. per share upon them, but failed to pay the remaining 10s., calls being duly made, the Directors could, after following the procedure outlined above, forfeit the shares and re-issue them as fully paid to A. B. at the price of 10s. per share, making 20s. in all. Forfeited shares may be re-issued as partly paid so long as the re-issue is not tantamount to an issue at a discount, otherwise the new holder becomes liable for the amount of the discount in addition to the unpaid calls when these are made in due course. Of course, if shares issued at a discount under S. 47 are forfeited, the amount of the discount must be taken into account.

Illustration.—X. Y., a shareholder in Blanks, Ltd., was allotted 200 ordinary shares of £1 each. He paid 5s. per share on application, and 5s. per share on allotment, but failed to pay the first and final call of 10s. per share. On June 30, 19.., the directors passed a resolution forfeiting the shares under the powers conferred upon them by the Articles.

The nominal capital of the company consisted of 100,000 shares of £1 each, all of which had been issued and subscribed.

The necessary entries are as follows :—

JOURNAL. 7

			Dr.			Cr.		
		L.F.	£	s.	d.	£	s.	d.
19... June 30	Ordinary Share Capital Account .. .. Dr. To Forfeited Shares Account .. .. Being 200 Ordinary Shares, fully called up, forfeited as per resolution of the Directors, dated this day.	1 3	200	0	0	200	0	0
,, 30	Forfeited Shares Account .. .. Dr. First and Final Call Account .. .. Being the amount remaining unpaid on the 200 Ordinary Shares forfeited as per previous entry.	3 5	100	0	0	100	0	0

Blanks, Limited.

LEDGER.

1 ORDINARY SHARE CAPITAL ACCOUNT. 1

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... June 30	To Forfeited Shares Account	7	200	0	0	19... June 1	By Balance	√	100,000	0	0
,, 30	,, Balance carried down	√	99,800	0	0						
		£	100,000	0	0			£	100,000	0	0
						19... June 30	By Balance brought down . ..	√	99,800	0	0

3 FORFEITED SHARES ACCOUNT. 3

Dr.		J.	£	s.	d.	Cr.		J.	£	s.	d.
19 .. June 30	To First and Final Call Account ..	7	100	0	0	19 .. June 30	By Share Capital Account	7	200	0	0
" 30	" Balance carried down	√	100	0	0						
			£200	0	0				£200	0	0
						19... June 30	By Balance brought down	√	100	0	0

5 FIRST AND FINAL CALL ACCOUNT. 5

Dr.		J.	£	s.	d.	Cr.		J.	£	s.	d.
19... June 30	To Balance brought forward	√	100	0	0	19... June 30	By Forfeited Shares Account .. .	7	100	0	0

Blanks, Limited.

BALANCE SHEET, JUNE 30, 19...

(LIABILITIES SIDE ONLY.)

		£	s.	d.
Capital:—				
Nominal:—				
100,000 Ordinary Shares of £1 each	£100,000 0 0			
Issued:—				
100,000 Ordinary Shares of £1 each, fully called	£100,000 0 0			
Less 200 shares forfeited as per resolution of Directors, dated June 30, 19..	200 0 0			
		99,800	0	0
Forfeited Shares Account, amount paid on shares forfeited as above		100	0	0

An alternative, and more direct, method is as follows :—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... June 30	Ordinary Share Capital Account .. .. Dr.		200	0	0			
	To First and Final Call Account					100	0	0
	" Forfeited Shares Account					100	0	0
	Being 200 Ordinary Shares, fully called up, forfeited as per resolution of the Directors, dated this day.							

Most companies, however, prefer the method set out on the previous page.

Reissue of Forfeited Shares.—In the illustration given above, the company has received £100 = 10s. per share on the 200 shares forfeited by X. Y. The issued capital of the company has been reduced by 200 shares, as shown in the Balance Sheet. Although, if the Articles so provide, a defaulting shareholder is still liable for the unpaid calls

on forfeited shares, it is the usual practice to treat the unpaid calls as a bad debt, and to take steps to reissue the shares to a fresh holder. Assuming that, in the illustration given above, the 200 shares are reissued on July 30, 19.., to R. Y., at the price of 10s. per share, the entries would be as follows :—

JOURNAL. 8

		L.F.	Dr. £	s.	d.	Cr. £	s.	d.
19... July 30	Forfeited Shares Reissued Account .. .. Dr.	5	200	0	0			
	To Ordinary Share Capital Account	1				200	0	0
	Being reissue of 200 Ordinary Shares forfeited on June 30, 19 ..							
" 30	Sundries .. .. Dr.							
	Cash (New Shareholder)..	C.B. 7	100	0	0			
	Forfeited Shares Account	L.F. 3	100	0	0			
	To Forfeited Shares Reissued Account	5				200	0	0
	Being amount already received and Cash paid by R. Y. on reissue of 200 Ordinary Shares as above.							

LEDGER.

1 Ordinary Share Capital Account. 1

Dr.			£	s.	d.		Cr.		£	s.	d.
19... July 30	To Balance carried down	√	100,000	0	0	19 .. June 30	By Balance brought down	√	99,800	0	0
						July 30	" Forfeited Shares Reissued Account	J. 8	200	0	0
		£	100,000	0	0			£	100,000	0	0
						19 . July 30	By Balance brought down	√	100,000	0	0

3 Forfeited Shares Account. 3

Dr.		J.	£	s.	d.		Cr.		£	s.	d.
19... July 30	To Forfeited Shares Reissued Account	8	100	0	0	19... June 30	By Balance brought down	√	100	0	0

5 Forfeited Shares Reissued Account. 5

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... July 30	To Ordinary Share Capital Account..	8	200	0	0	19... July 30	By Sundries	16	200	0	0

7 CASH BOOK. 7

(Debit Side Only.)

Dr.			£	s.	d.
19... July 30	To Cash. R. Y., in respect of 200 Ordinary Shares reissued ..		100	0	0

The more direct method of entry is shown in the next example.

Reissue of Forfeited Shares at a Premium.—If forfeited shares are reissued at a higher price than the amount outstanding upon them, the extra amount received represents a premium, and should be treated as a capital profit and used to strengthen the company's reserves. Reverting again to the illustration given above, and assuming that the 200 shares in question were sold to R. Y. for £150, the necessary entries would be as follows :—

8 JOURNAL

			Dr. £	s.	d.	Cr. £	s.	d.
19.. July 30	Sundries :— Dr.							
	R. Y. (Cash)		150	0	0			
	Forfeited Shares Account		100	0	0			
	To Sundries :—							
	Ordinary Share Capital Account					200	0	0
	Premium on Shares Account..					50	0	0
	Being reissue of 200 Ordinary Shares forfeited to R. Y. at the price of £150 as per resolution of even date.							

10 LEDGER. 10

PREMIUM ON SHARES ACCOUNT.

Dr.			£	s.	d.				£	s.	d. Cr.
						19... July 30	By R. Y. reissue of 200 shares	J.	50	0	0

The premium on shares, £50, would appear on the liabilities side of the Balance Sheet as a separate item after the statement of Share Capital.

EXAMINATION QUESTION.

The Directors of Blanks, Ltd., decided to forfeit 500 Ordinary Shares, standing in the name of X. Y. Z., on the ground that the final call of 5s. per share remained unpaid after several applications.

The Company's £1 Ordinary Shares were issued at a premium of 2s. 6d. per share, and were payable as follows : On application (May 1st), 5s. per share ; on allotment (May 15th), 7s. 6d. per share, including the premium ; on June 1st, 5s. per share ; on July 1st, 5s. per share.

Give the entries necessary to record this forfeiture. (*Royal Society Arts.*)

Solution.

3 JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Aug. 1	Ordinary Share Capital Account .. .. Dr.	1	500	0	0			
	To Forfeited Shares Account	5				500	0	0
	Being 500 Ordinary Shares of £1 each, fully called up, forfeited by resolution of the Directors, dated							
" 1	Forfeited Shares Account .. .. Dr.	5	125	0	0			
	To Second Call Account	7				125	0	0
	Being amount (5s. per share) unpaid on 500 shares forfeited as above.							

LEDGER.

Ordinary Share Capital Account.

(Say 50,000 Shares of £1 each.)

1 Dr. Cr. 1

Date		J.	£	s.	d.	Date		J.	£	s.	d.
19... Aug. 1	To Forfeited Shares Account	3	500	0	0	19... May 1	By Application Account	J.	12,500	0	0
" 1	" Balance carried down		49,500	0	0	" 15	" Allotment Account	J.	12,500	0	0
						June 1	" 1st Call Account	J.	12,500	0	0
						July 1	" 2nd Call Account	J.	12,500	0	0
		£	50,000	0	0			£	50,000	0	0
						19... Aug. 1	By Balance brought down	√	49,500	0	0

Premium on Shares Account.

3 Dr. Cr. 3

			£	s	d.	Date			£	s.	d.
						19... May 15	By 2s. 6d. per share on 50,000 shares	J.	6,250	0	0

Forfeited Shares Account.

5 Dr. Cr. 5

Date		J.	£	s.	d.	Date		J.	£	s.	d.
19.. Aug. 1	To Second Call Account	3	125	0	0	19... Aug. 1	By Ordinary Share Capital Account	3	500	0	0
" 1	" Balance carried down..	√	375	0	0						
			£500	0	0				£500	0	0
						19... Aug. 1	By Balance brought down	√	375	0	0

Second Call Account.

7 Dr. Cr. 7

Date		J.	£	s.	d.	Date		J.	£	s.	d.
19... July 1	To Share Capital Account	2	12,500	0	0	19... July 1	By Cash, Sundry Shareholders ..	C.B.	12,375	0	0
						" 1	" Forfeited Shares Account	J. 3	125	0	0
		£	12,500	0	0			£	12,500	0	0

The Application and Allotment, and First Call Accounts would duplicate the Second Call Account given above, except that the credit entry would be "By Cash, £12,500," and need not be repeated here. The tendency of many candidates is to write back the premium of 2s. 6d. per share on X. Y. Z.'s 500 shares. The premium would, of course, be forfeited, together with the amounts paid on Application and Allotment, and First Call Accounts, and would remain in the Premium on Shares Account as shown above.

In view of the provisions of S. 63 that a transfer of shares must not be registered except on production of an instrument of transfer, it would appear to be necessary for a nominee of the company to execute a transfer to the person to whom the shares are re-issued.

Surrender of Shares.—Shares may be surrendered if the Articles authorise surrenders, but to avoid a technical reduction of capital, the sanction of the Court must first be obtained, unless the circumstances of the case justify the ordinary procedure of forfeiture. Forfeiture is the best and shortest course to pursue in suitable circumstances. Surrendered shares may be reissued on the principles already explained in connection with forfeited shares. The most common circumstances leading to a surrender of shares arise in connection with the purchase of a business, or assets which turn out to be less valuable than was assumed at the time of purchase.

Illustration.—A. B. sold his business to Blanks, Ltd., as a going concern for £100,000, payable as to £25,000 in cash and £75,000 in fully paid shares. The stock taken over fell heavily in value owing to market depreciations, and some large book debts proved to be irrecoverable. In view of this, A. B. agreed to surrender £25,000 of the shares allotted to him. Assuming the surrender to have been effected with the sanction of the Court and by the ordinary process of surrender, the effect on the company's Balance Sheet would be as follows :—

Blanks, Limited.

BALANCE SHEET, DECEMBER 31, 19...

	£	s	d.		£	s.	d.
Capital :—				Purchase of Business Account £100,000			
75,000 Ordinary Shares of £1 each issued as fully paid £75,000				*Less* shares surrendered by A. B. 25,000	75,000	0	0
Less shares surrendered by A. B. 25,000	50,000	0	0				

Liens and Charges on Shares.—The majority of Articles provide that the company shall have a lien on shares and dividends, for calls or debts due from members to the company. The rules of the Stock Exchange prohibit the extension of this power to fully paid shares.

As an alternative to forfeiture, therefore, the company may sue the defaulting member, or may stand on its lien, and sell the shares. Table A empowers the company to sell shares on which it has a lien for moneys presently payable, after giving the defaulter at least fourteen days' notice in writing of the intention to do so if the moneys are not paid. The company can authorise a nominee to execute a transfer giving effect to the sale. The defaulter is entitled to any surplus realised.

Loans are frequently obtained from bankers and others on the security of shares. It is not usual for an actual transfer of the shares

to be registered by the company in favour of the lender. Generally the borrower deposits with the lender his share certificate or certificates, accompanied by a transfer in blank, i.e. a transfer with no transferee's name filled in. This gives the lender an equitable title to the shares. The company is not affected by this procedure, since companies must take no notice of equities or trusts. But, although the company cannot register a notice of any equitable interest of third parties, it loses its own priority of lien on receipt of such notice (*Bradford Banking Co.* v. *Briggs* [1886]). The lender takes the risk of fraud on the part of the borrower, or of bankruptcy proceedings being instituted against him. But he can protect himself by applying for, and filing with the Supreme Court, a document termed a *Notice in Lieu of Distringas*. A certified copy of this notice when served on the company will prevent the transfer of the shares, or the payment of dividends without prior notice being given to the lender.

Redemption of Redeemable Preference Shares.—The law regulating such redemption has been stated at p. 301. It is now sufficient to give an illustration.

Illustration.—Uprichards, Ltd., had issued 20,000 Redeemable Preference Shares of £1 each, redeemable on 30th September, 19.., at 22s. 6d. per share. On that date, the company had a Reserve of £14,000 and a balance at the credit of Profit and Loss Account of £500, and the directors decided to utilise these resources in redeeming the shares, raising the balance of the money by the issue of Ordinary Shares of £1 each at a premium of 5s. per share, payable in full on application. Show by Journal entries the records of these transactions.

JOURNAL

			Dr. £	s.	d.	Cr. £	s.	d.
19.. Sept 30.	Premium on Shares Account .. .. Dr.		1,600	0	0			
	To Reserve Account					1,600	0	0
	Redeemable Preference Shares Account .. Dr.		20,000	0	0			
	Profit and Loss Account .. .. Dr.		500	0	0			
	Reserve Account .. .. Dr.		2,000	0	0			
	To Cash					22,500	0	0
	20,000 Redeemable Preference Shares of £1 each fully paid, now redeemable, and provision of premium of 2s. 6d. per share, in accordance with S. 46 [1(*d*)].							
	Reserve Account .. .. Dr.		13,600	0	0			
	To Capital Redemption Reserve Fund					13,600	0	0
	Transfer in accordance with S. 46 [1(*c*)].							

Issue of Debentures.—The opening entries necessary for recording an issue of debentures are similar to those required for recording an issue of shares. For example :—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 12	Debenture Application and Allotment Account .. Dr. To 5 % Debentures Account							
" 12	Debenture Call Account.. .. .. Dr. To 5 % Debentures Account .. .. (and so on)							

Separate Application and Allotment Sheets, Cash Book, and Banking Account should be opened in the case of a large issue of debentures in order to facilitate registration and audit. Debentures are usually payable in full, either on application or by two or three instalments over a short period.

Issue of Debentures at a Premium.—Debentures, like shares, may be issued at any premium that can be commanded. The entries necessary are similar to those required for a share issue at a premium.

Illustration.—Uprichards, Ltd., offered for subscription on December 12, 19.., 1,000 5 % Debentures of £100 each at the price of £110, payable as to £20 on application and £90 (including the premium) on allotment. The whole issue was subscribed and allotted, and the moneys due were paid on or before December 18, 19...

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 18	Debenture Application and Allotment Account.. Dr. To 5 % Debenture Account .. .. " Premium on Debentures Account .. .. .. Being £20 per debenture of £100 on application and £90 on allotment as per resolution of the Directors, dated December 18, 19...		110,000	0	0	 100,000 10,000	 0 0	 0 0

The Ledger accounts will be similar to those already illustrated in the case of an issue of shares at a premium.

As with premiums on shares so with premiums on debentures, it is suggested that they should be separately stated on the liabilities side of the Balance Sheet and treated as a capital reserve, although here also, in the absence of express prohibition to the contrary in the Articles, there appears to be nothing to prevent such profits from being treated as ordinary revenue.

Issue of Debentures at a Discount.—Debentures may be issued at a discount if so authorised by the Articles. But where they are so issued, the terms of issue may not include an option to convert the debentures into their par value of fully paid shares, for that would be

tantamount, if taken advantage of, to an issue of shares at a discount—an illegal proceeding (*Moseley* v. *Koffyfontein Mines*, [1904]), unless the shares are validly issued at a discount under S. 47. Students appear to find difficulty in the fact that whereas debentures may, shares may not, except under S. 47, be issued at a discount. The reason is that a shareholder is really equivalent to a partner in the company, whereas the debenture holder is a creditor of the company. The amount of discount on debentures, or shares (issued under S. 47), and any commissions payable on the issue, must be stated in the Prospectus (Fourth Schedule), and must be set out separately in the company's Balance Sheet until written off (S. 44). The discount must also be stated in the Annual Return (S. 108 [3 (*g*) (*h*)]).

Issues at a discount seem to present difficulties to some students, but carefully considered the procedure is quite simple. The essential fact to remember is that the company is under liability to repay the *full face value* of the debentures on maturity. The issue to-day of a £100 debenture at £95, repayable ten years hence, means that although upon issue the company receives but £95, it will have to pay £100 on the date of maturity. The company must therefore acknowledge the full liability for £100 in its books, and treat the £5 discount as a temporary asset, and write it off during the life of the debenture. This discount practically amounts to deferred interest paid in a lump sum upon maturity of the debenture.

The simple rule to remember is :—

(*a*) *Credit Debentures Account with the full amount repayable on maturity, and* (*b*) *debit to Discount on Debentures Account the difference (discount) between* (*a*) *and the actual cash received.*

Illustration.—On January 1, 19.., Soleil d'Or, Ltd., offered for subscription 550 5 % Debentures of £100 each at the price of 95, payable as to £20 on application, £40 on allotment, and £35 on March 1, 19... The whole issue was subscribed and allotted, and the amounts due were paid on or before March 1, 19...

JOURNAL. 1

			Dr.			Cr.		
19...		L.F.	£	s.	d.	£	s.	d.
Jan. 5	Debenture Application and Allotment Account .. Dr.	6	33,000	0	0			
	To 5 % Debentures Account..	5				33,000	0	0
	Being £20 on application, and £40 on allotment, on 550 5 % Debentures issued at 95 as per resolution of Directors, dated January 5, 19...							
Mar. 1	Debenture Final Call Account .. .. Dr.	8	19,250	0	0			
	To 5 % Debentures Account..	5				19,250	0	0
	Being final call of £35 per debenture on 550 5 % Debentures issued at 95 as above							
" 1	Debenture Discount Account .. .. Dr.	7	2,750	0	0			
	To 5 % Debentures Account..	5				2,750	0	0
	Being discount at £5 per debenture on 550 5 % Debentures issued at 95 as above.							

LEDGER.

5 — 5 % Debentures Account. — 5

Dr.			£	s.	d.		Cr.		£	s.	d.
						19... Jan. 5	By Debenture Application and Allotment Account	J. 1	33,000	0	0
						Mar. 1	,, Final Call Account .. .	√	19,250	0	0
						,, 1	,, Debenture Discount Account	√	2,750	0	0
								£	55,000	0	0

6 — Debenture Application and Allotment Account. — 6

Dr.		J.	£	s.	d.		Cr.	C.B.	£	s.	d.
19... Jan. 1	To 5 % Debentures Account	1	33,000	0	0	19... Jan. 5	By Cash	3	33,000	0	0
		£	33,000	0	0			£	33,000	0	0

7 — Debenture Final Call Account. — 7

Dr.		J.	£	s.	d.		Cr.	C.B.	£	s.	d.
19... Mar. 1	To 5% Debentures Account ..	1	19,250	0	0	19... Mar. 1	By Cash	3	19,250	0	0
		£	19,250	0	0			£	19,250	0	0

8 — Debenture Discount Account. — 8

Dr.		J	£	s.	d.		Cr.		£	s.	d.
19... Mar. 1	To 5% Debentures Account ..	1	2,750	0	0						

3 — CASH BOOK. — 3

Dr.			£	s.	d.		Cr.		£	s.	d.
19... Jan. 5	To Cash, Sundry Debenture Holders Application and Allotment	6	33,000	0	0						
Mar. 31	To Cash, Debenture Final Call Account.. ..	7	19,250	0	0						

EXAMINATION QUESTION.

A limited company having decided to issue £10,000 5 % debentures, namely, 100 of £100 each at a discount of 5 %, arrange with Softleigh & Co. to underwrite the whole issue at a commission of 5 % on the nominal value. In due course 90 debentures were subscribed, paid for and allotted, the remaining 10 debentures being allotted to Softleigh & Co. as per their underwriting agreement. You are required to show the accounts in the Company's books necessary to record these transactions, including the account with Softleigh & Co., also state how the debentures will appear on the next Balance Sheet of the Company. (*London Association Accountants.*)

Solution.

JOURNAL. 16

			Dr. £	s.	d.	Cr. £	s.	d.
	Debenture Application and Allotment Account .. .. Dr.	3	8,550	0	0			
	To 5 % Debentures					8,550	0	0
	Being 90 debentures of £100 each issued at a discount of 5 % to the public as per resolution of Directors, dated							
	Softleigh & Co. (Underwriters) .. .. Dr.	9	950	0	0			
	To 5 % Debentures	5				950	0	0
	Being 10 debentures at a discount of 5 % not taken up by the public and now allotted to the underwriters as per resolution of Directors, dated							
	Debenture Discount .. .. Dr	7	500	0	0			
	To 5 % Debentures	5				500	0	0
	Being 5 % discount on 100 debentures of £100 each.							
	Debenture Issue Expenses Account .. .. Dr.	11	500	0	0			
	To Softleigh & Co	9				500	0	0
	Being 5 % underwriting commission on 100 debentures of £100 each.							

1 CASH BOOK. 1

Dr. / Cr.

			£	s.	d.				£	s.	d.
	To Cash, Sundry Debenture Holders (Application and Allotment Moneys)	3	8,550	0	0						

LEDGER.

3 Debenture Application and Allotment Account. 3

Dr. / Cr.

		J.	£	s.	d.			C.B.	£	s.	d.
	To 5 % Debentures Account	16	8,550	0	0		By Cash	1	8,550	0	0

5 — 5 % Debentures Account. — 5

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
							By Debenture Application and Allotment Account ..	16	8,550	0	0
							" Softleigh & Co. ..	—	950	0	0
							" Debenture Discount Account ..	—	500	0	0
								£	10,000	0	0

7 — Debenture Discount Account. — 7

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
	To 5 % Debentures Account	16	500	0	0						

9 — Softleigh & Co. — 9

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
	To 5 % Debentures Account	16	950	0	0		By Underwriting Commission	16	500	0	0
							" Balance carried down	√	450	0	0
			£950	0	0				£950	0	0
	To Balance brought down	√	450	0	0						

11 — Debenture Issue Expenses Account. — 11

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
	To Softleigh & Co., Underwriting Commission	16	500	0	0						

BALANCE SHEET.

	£	s.	d.		£	s.	d.
5 % Debentures :— 100 Debentures of £100 each ..	10,000	0	0	Debenture Discount Account ..	500	0	0
				Debenture Issue Expenses Account	500	0	0
				Sundry Debtors (Softleigh & Co.)	450	0	0
				Cash	8,550	0	0

Purchase of Debentures in Open Market.—When the conditions of issue, or the provisions of the Trust Deed, empower a company to redeem its debentures by purchasing them in open market, the necessary entries are as follows:—

Illustration.—Uprichards, Ltd., in conformity with their Debenture Trust Deed, purchased the following debentures: March 15th, from John Smith, five 5 % debentures of £100 each at £102; March 26th, from Wm. Robinson, six 5 % debentures of £100 each at £98. The expenses in connection with the purchases were £5. Ignore accrued interest.

In actual practice, the cash purchases of debentures would pass through the Cash Book. The double-entry aspect of the transactions as a whole is set out in the Journal entries given below.

JOURNAL. 13

			Dr. £	s.	d.	Cr. £	s.	d.
	Debenture Purchase Account .. .. Dr.	3	1,098	0	0			
	To Sundries:—							
	John Smith	7				510	0	0
	William Robinson	9				588	0	0
	Being purchase of £500 Debentures at 102, and £600 at 98 respectively.							
	5 % Debenture Stock Account .. .. Dr.	5	1,100	0	0			
	To Debenture Purchase Account	3				1,100	0	0
	Being debentures purchased as above.							
	Debenture Purchase Expenses Account .. .. . Dr.	11	10	0	0			
	To Debenture Purchase Account	3				10	0	0
	Being premium on purchase from John Smith as above.							
	Debenture Purchase Account .. .. Dr.	3	12	0	0			
	To Debenture Purchase Expenses Account	11				12	0	0
	Being discount on purchase from William Robinson as above.							

CASH BOOK. 2

Dr. / Cr.

			£	s.	d.	19...			£	s.	d.
						Mar. 15	By John Smith ..	7	510	0	0
						„ 26	„ Wm. Robinson..	9	588	0	0
						„ 26	„ Expenses on Debenture Purchases	11	5	0	0

LEDGER.

3 DEBENTURE PURCHASES ACCOUNT. 3

Dr. / Cr.

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Mar. 15	To John Smith ..	13	510	0	0	Mar. 26	By 5 % Debenture Stock Account..	13	1,100	0	0
„ 26	„ Wm. Robinson	13	588	0	0	„ 26	„ Debenture Purchases Expenses Account	13	10	0	0
„ 26	„ Debenture Purchases Expenses Account	13	12	0	0						
		£	1,110	0	0			£	1,110	0	0

5 5 % DEBENTURE STOCK (TRUSTEES') ACCOUNT. 5

DR.										CR.	
19...		J.	£	s.	d.				£	s.	d.
Mar. 26	To £1,100 Debentures Purchased	13	1,100	0	0						

7 JOHN SMITH 7

DR.										CR.	
19...		C.B.	£	s.	d.	19...		J.	£	s.	d.
Mar. 15	To Cash	2	510	0	0	Mar. 15	By £500 Debentures	13	510	0	0

9 WILLIAM ROBINSON. 9

DR.										CR.	
19...		C.B.	£	s.	d.	19...		J.	£	s.	d.
Mar. 26	To Cash	2	588	0	0	Mar. 26	By £600 Debentures	13	588	0	0

11 DEBENTURE PURCHASES EXPENSES ACCOUNT 11

DR.										CR.	
19...		J.	£	s.	d.	19...		J.	£	s.	d.
Mar. 15	To Debenture Purchases Account	13	10	0	0	Mar. 26	By Debenture Purchases Account	13	12	0	0
" 26	" Cash	C.B. 2	5	0	0	" 26	" Balance carried down	√	3	0	0
			£15	0	0				£15	0	0
19...											
Mar. 26	To Balance brought down .. .	√	3	0	0						

NOTE—At the close of the year, the balance of this account would be transferred to Profit and Loss Account. Since the cash resources have been depleted, it is also advisable, in order to preserve working capital, to transfer from Profit and Loss Account (Appropriation Section) to General Reserve Account an amount equal to the cash cost of purchasing the debentures—in this case £1,100 (the other £3 will be written off).

Debenture Issue Expenses.—Considerable expense attaches to a Debenture issue. The expenses will probably include: Underwriting commission, brokerage paid to stockbrokers and others for placing bonds, advertising, printing, law costs, statutory filing fees, and *ad valorem* duty. These expenses will appear as payments on the credit side of the Cash Book, or as credits to personal accounts, and should be posted to the debit of a separate ledger account headed Debenture Issue Expenses Account. The balance of this account must appear as a separate item in the Balance Sheet (S. 124 [1(*b*)]), and should be written off in instalments over the life of the debentures, or, preferably, within a shorter period.

In this connection, also, some students appear to find difficulty. Briefly put, these expenses represent an actual *loss* incurred in raising

money by means of a debenture issue. Clearly this loss must be extinguished on or before the maturity of the debentures. It is reasonable, however, to assume that all the years between issue and maturity will benefit by the employment of the money borrowed. That being so, it is legitimate to spread the expenses over the life of the issue, although it is preferable to extinguish the item sooner.

If the issue is redeemable by annual drawings of fixed amount, it is theoretically correct to apportion the expenses on the basis of the amount of debentures outstanding, so that all the years which benefit from the loan shall bear their due proportion of the expenses. Practical experience, however, shows that most companies endeavour to eliminate the item more expeditiously than adherence to this theory would permit.

Premiums and Discount in Balance Sheet.—The method of setting out premiums and discount in the Balance Sheet can best be shown by an example :—

Illustration—The nominal capital of Uprichards, Ltd., consists of £200,000, divided into 100,000 ordinary shares of £1 each and 100,000 7 % preference shares of £1 each. The whole of the shares were offered for subscription. Of the ordinary shares, 85,000 were applied for, allotted, and fully called up. All calls were paid, except the final call of 5s. per share on 1,000 shares. The preference shares were issued at a premium of 2s. 6d. per share, and were fully subscribed, allotted, and paid up. The company also issued 500 5 % debentures of £100 each at 95. The issue was fully subscribed, allotted, and paid up. The expenses of issue were £1,500. The debentures were repayable in five years from the date of issue, and the Directors decided to write off the discount and expenses in equal annual instalments over that period. Give the necessary entries recording the position at the close of the year immediately following the above issues as shown in the company's Balance Sheet. (*See next page.*)

Debenture Interest.—Interest on debentures is usually payable half-yearly. As it represents interest on a loan, it must be paid whether profits are made or not. Income tax at the current rate must be deducted from the interest when paid. A debenture interest warrant is illustrated on p. 397.

Debenture Interest Book.—When the debenture holders are numerous, it is usual to keep a Debenture Interest Book. A suitable ruling for this book is given on p. 396.

Debenture Coupons.—Debenture bonds made out to bearer are negotiable instruments. Interest on them is paid by means of detachable Interest Coupons covering a series of years, attached to the bonds, and made payable on the dates when the interest on the bonds falls due. It is usual to keep a *Coupon List* recording the numbers of all bonds issued and to note therein the due date and payment of the coupons attached to the bonds. A ruling for a Coupon List is illustrated on p. 396.

Uprichards, Limited.

BALANCE SHEET, DECEMBER 31, 19...

		£	s	d.			£	s.	d.
Capital :—									
Nominal—									
100,000 Ordinary Shares of £1 each	£100,000 0 0								
100,000 7 % Preference Shares of £1 each ..	100,000 0 0								
	£200,000 0 0								
Issued—									
85,000 Ordinary Shares of £1 each fully called up	£85,000 0 0								
Less Calls in arrear	250 0 0								
	84,750 0 0								
100,000 7 % Preference Shares of £1 each ..	100,000 0 0								
		184,750	0	0					
Premiums on Preference Shares		12,500	0	0	Debenture Discount Account	£2,500 0 0			
5 % Debentures—					*Less* One-fifth written off	500 0 0			
500 Debentures of £100 each		50,000	0	0			2,000	0	0
					Debenture Expenses Account	£1,500 0 0			
					Less One-fifth written off	300 0 0			
							1,200	0	0

Entries on Payment of Debenture Interest.—When the debenture interest for a period becomes due the necessary entries are :—

JOURNAL.

			Dr.			Cr.		
19...			£	s.	d.	£	s.	d.
Dec. 31	Debenture Interest Account .. .. Dr.		500	0	0			
	To Sundry Debenture Holders					400	0	0
	,, Income Tax					100	0	0
	Being interest for the half-year due this day on £20,000 5 % Debentures less tax at 4s. in the £*							

* Or whatever the current rate of tax may be.

The Sundry Debenture Holders' Account will automatically close when all the interest warrants have been paid. The income tax deducted will, as already explained in connection with the income tax deducted from Dividends, remain at the credit of Income Tax Account pending the final adjustment of all income tax due by the company for the financial period.

In the case of large issues, a separate banking account is opened, the net amount payable to the debenture holders being credited to it by means of a transfer from the main banking account. This banking account will automatically close when all the warrants have been presented and paid.

Unclaimed Debenture Interest.—If, when the annual accounts are prepared, a balance remains on the Sundry Debenture Holders' Account, it will represent unclaimed debenture interest, and should be added "short" to the debentures and the total extended to the outer columns in the Balance Sheet. If a separate banking account has been opened for the service of debenture interest, a similar amount will remain as a balance in hand and should be separately stated amongst the various bank balances. If no separate banking account has been opened, the unclaimed interest will, of course, be merged in the general bank balance. See the reference to the *Burnham* Case on p. 361 as to such interest becoming Statute barred.

Redemption of Debentures.—With the exception of irredeemable debentures, all loans of this kind are repayable at certain fixed dates. In the case of Governments or Corporations whose issues are popular with investors, a fresh loan is usually relied upon to replace one falling due, and, frequently, holders of the old loan have the option of converting into the new on favourable terms. But in the case of ordinary commercial issues, provision must be made so that the funds necessary for redemption may be available when the issue matures. There are various ways of redeeming debentures. (*a*) A sinking fund may be created by the annual purchase of gilt-edged Stock Exchange securities ; (*b*) the debentures may be purchased in the open market ; (*c*) a Capital Redemption Policy may be taken out by the company ; (*d*) there may be annual drawings of fixed amount.

DEBENTURE INTEREST BOOK.

No. of Interest Warrant.	Debenture Register Folio.	Name of Payee.	Address of Payee.	Debentures Held.			Interest for Half-year to .. at .. %.			Income Tax Deducted. Rate ...			Net Amount of Warrant.			When Paid by Bank.	Remarks.
				£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.		

COUPON LIST.

No. of Bearer Bond.	Date of Issue.	Due Dates of Coupons and Dates Paid.							
		Due.	Paid.	Due.	Paid.	Due.	Paid.	Due.	Paid.

(*Debenture Interest Warrant.*)

UPRICHARDS, LIMITED.

32

532 Oxford Street, W. 1.
January 1, 19...

A. N. Other, Esq.,
Spencer House,
E.C. 2.

Dear Sir or Madam,

Herewith I have the pleasure to hand you a warrant for the interest on your debenture stock as under for the six months ended December 31, 19.., less Income Tax, which I hereby certify will be accounted for by the Company to the proper officer for the receipt of taxes. This statement will be accepted by the Inland Revenue as proof of payment of the tax in claiming exemption from, or return of, Income Tax.

G. W. Both,
Secretary.

This portion of the Interest Warrant to be retained by the Proprietor.

Holding.		£	s.	d.
£353	4 % 1st Debenture Stock at £2 per £100 Stock	7	1	2
£	4½ % 2nd Debenture Stock at £2 5s. od. per £100 Stock			
	Total	7	1	2
	Less Income Tax at 4s. od. in the £ ..	1	8	3
	Net Amount	£5	12	11

(*Perforation.*)

UPRICHARDS, LIMITED.

32

Warrant for Interest for Half-year ended December 31, 19...

No. 1243.

London,
January 1, 19...

To National Provincial Bank, Limited,
Princes Street, E.C.

Pay *A. N. Other, Esq.*

Five pounds, twelve shillings and eleven pence.

Stamp

For and on behalf of
Uprichards, Limited.

£5 12 11.

G. W. Both, Secretary.
A. Always, Asst. Secretary.

Signature of Payee................

This warrant must be presented for payment within six months from date.

Illustration (a). Sinking Fund.—Soleil d'Or, Ltd., issue £100,000 of debentures redeemable in twenty years. It is decided to provide the funds for redemption by an annual investment in first-class securities of a sum which at 3 % per annum compound interest will produce the amount required for redemption. The annual sum to be invested is the amount which annually invested at 3 % compound interest will in twenty years produce the capital amount to be redeemed. From the Tables we find that the sum required to be invested at 3 % compound interest to produce £1 in twenty years is £0·0372. Multiplying this by 100,000, we obtain £3,720 as the annual instalment to be invested at 3 % compound interest to produce £100,000 in twenty years. This amount will be appropriated from profits and credited to Redemption of Debentures Sinking Fund Account, and an equivalent amount of cash invested at the beginning of each year. All interest accrued will also be credited to the account and immediately invested. The Journal entry will be as follows :—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19 .. Dec. 31	Profit and Loss Account (Appropriation Section) Dr.		3,720	0	0			
	To Redemption of Debentures Sinking Fund Account					3,720	0	0
	Being the annual instalment required for the redemption of the debentures as per the conditions of issue.							
„ 31	Investment of Sinking Fund Account .. .. Dr.		3,720	0	0			
	To Cash					3,720	0	0
	Being purchase of investment.							
	(*Note.*—In practice this purchase would be posted direct from the Cash Book—no Journal entry being made.)							

On initiation of the fund, the purchase of the investment (£3,720) will appear as a payment on the credit side of the Cash Book, from which it will be posted direct to the debit of the Investment of Sinking Fund Account. When the second instalment of £3,720 becomes due, it will be added to the interest (£111 12s.) received on the first instalment for the past year, and £3,831 12s. will be invested ; and so on from year to year throughout the twenty years.

The annual appropriations from Profit and Loss Account, and the annual interest received, will be posted to the credit of the Redemption of Debentures Sinking Fund Account ; the annual purchases of investments will be credited to Cash and debited to Investment of Sinking Fund Account.

When the debentures mature for payment, the investments will be realised and the proceeds be credited to the Investment of Sinking Fund Account ; the debentures will be paid off and the Debentures Account debited with the payment ; and the Sinking Fund will be transferred to general reserve, in which it becomes merged.

The relative ledger accounts are simple and need not be illustrated.

An illustration of the purchase of debentures in the open market has already been given on p 391. It may, however, be useful to extend the principles there illustrated to purchases of debenture stock.

Illustration (b). Purchase in Open Market.—The Articles of Soleil d'Or, Ltd., provide for the purchase of the company's 5 % debenture stock in the open market at a price not exceeding £102 per £100 debenture stock. £80,000 of the stock had been issued and fully paid up. During the year 19.. the company purchased thirty debentures at 98 in the open market. A circular was sent to every debenture stock holder enclosing a tender form as illustrated on p. 400. Ten debenture stock holders, holding an aggregate of forty debentures, sent in tenders at 97½ per debenture, and these were accepted. All purchases were completed on January 5, 19... Ignore accrued interest.

The entries are as follows :—

Dr. 5 % DEBENTURE STOCK. Cr.

			£	s.	d.				£	s.	d.
19... Jan. 5	To Cash, £3,000 Debenture Stock at 98		2,940	0	0	19... Dec. 31	By Balance		80,000	0	0
" 5	" Cash, £4,000 Debenture Stock at 97½		3,900	0	0						
" 5	" Discount on Redemption of Debenture Stock Account		160	0	0						
" 5	" Balance carried down		73,000	0	0						
		£	80,000	0	0			£	80,000	0	0
						19... Jan. 5	By Balance brought down		73,000	0	0

Dr. CASH BOOK. Cr.

			£	s.	d.				£	s.	d.
						19... Jan. 5	By Cash, purchase of £3,000 Debenture Stock at 98		2,940	0	0
						" 5	" Cash, purchase (by tender) of £4,000 Debenture Stock at 97½..		3,900	0	0

DISCOUNT ON REDEMPTION OF DEBENTURE STOCK ACCOUNT.

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Jan. 5	By 5 % Debenture Stock Account ..		160	0	0

It is submitted that the profit on the purchase of debentures should be treated as a capital profit, and not as ordinary revenue. The contention of those who would treat such profits as ordinary revenue is that the saving effected by the redemption represents a capitalised reduction of interest on a debt.

If a direct appropriation from profits is made for the redemption of debentures, a further entry is necessary, viz. debiting Profit and Loss Account (Appropriation Section) and crediting Debenture Redemption Reserve Account or General Reserve Account with the amount appropriated. This is certainly generally advisable, in order that working capital may be preserved.

The amount of the debentures redeemed will, of course, appear in the Balance Sheet as a deduction from the original issue as follows :—

	£	£
5 % Debenture Stock—		
800 Debentures of £100 each	80,000	
Less 70 Debentures of £100 each redeemed to date	7,000	
		£73,000

Sometimes the debentures are held by the Debenture Holders' Trustees, and appear as an investment on the asset side of the Balance Sheet, in which case, of course, no deduction is made from the liability.

TENDER.

SOLEIL D'OR, LIMITED.

5 % FIRST MORTGAGE DEBENTURE STOCK.

TENDER OF DEBENTURE STOCK.

.... 19...

To the Directors of
SOLEIL D'OR, LIMITED,
532 OXFORD STREET, W.

I ....
of ....
hereby tender £........ of the above stock registered in my name at £........ per £100 of Debenture Stock, this price to include accrued interest; and if this offer, or any part thereof, be accepted, I hereby undertake to surrender corresponding certificates for the stock, and to execute any transfer of such stock as you may require.

Yours truly,

Signature ....
Address ....
Occupation ....

Illustration (c). Capital Redemption Policy.—Soleil d'Or, Ltd., issued £50,000 of 5 % debentures, the whole of which were subscribed and fully paid up. In order to provide for the redemption of the debentures, a Capital Redemption Policy was taken out securing the payment of £50,000 on the maturity date of the debentures. The annual premium on the policy was £3,895. The entries are as follows :—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Profit and Loss (Appropriation Section) .. .. Dr.		3,895	0	0			
	To Sinking Fund for Redemption of Debentures					3,895	0	0
	Being the annual instalment on the fund for the redemption of the 5 % Debentures as per condition of issue.							
" 31	Debenture Redemption Policy Account .. .. Dr.		3,895	0	0			
	To Cash					3,895	0	0
	Being the annual premium on Policy No. A37452 for the service of the above fund. (*Note.*—This amount would be posted direct from the Cash Book in actual practice.)							

The endowment policy method is probably a little more costly than the investment of the sinking fund in Stock Exchange securities. But it has the advantage of ensuring that the exact sum required will be forthcoming at the maturity date. The investment method can only be approximate, and should depreciation in the investments occur, the sum realised by sale would be inadequate to discharge the debentures.

Illustration (*d*). *Annual Drawings.*—Soleil d'Or, Ltd., issued and allotted £50,000 5 % debentures. By the terms of issue, the company was to repay 50 debentures of £100 at par, on December 31st of each year, by annual drawings. The company's profits for the first year were £15,787. The drawing took place, and £5,000 of the stock was duly paid off on January 2, 19...

The necessary entries are :—

5 PROFIT AND LOSS ACCOUNT. 5

Dr.			£	s.	d.		Cr.		£	s.	d.
19... Dec. 31	To Redemption of Debentures Account		5,000	0	0	19... Dec. 31	By Balance brought down		15,787	0	0
" 31	" Balance carried down		10,787	0	0						
		£	15,787	0	0			£	15,787	0	0
						19... Dec. 31	By Balance brought down		10,787	0	0

109 CASH BOOK. 109

Dr.			£	s.	d.		Cr.		£	s.	d.
						19... Jan. 5	By Cash, Repayment of Bonds Nos. 12 72, 89, 98, 108, 112, 128, 142, 172, 191, drawn this day	41	5,000	0	0

71 REDEMPTION OF DEBENTURES ACCOUNT. 71

DR. CR.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Profit and Loss Account	5	5,000	0	0

41 5 % DEBENTURES ACCOUNT 41

DR. CR.

			£	s.	d.				£	s.	d.
19 .. Jan. 5	To Cash	109	5,000	0	0	19... Dec. 31	By Balance	√	50,000	0	0
" 5	" Balance carried down	√	45,000	0	0						
		£	50,000	0	0			£	50,000	0	0
						19... Jan. 5	By Balance brought down	√	45,000	0	0

Reissue of Debentures.—Debentures that have been redeemed may be reissued unless the Articles or the terms of issue forbid that course (S. 75). Sometimes the debentures are merely indorsed with a transfer to the new holder; sometimes they are replaced by fresh bonds. In both cases restamping is necessary. No fresh entry in the Register of Charges is required unless a fresh charge is created. The book-keeping entries are simple, viz. a credit to cash and a debit to the old Debenture Account for the repayment, and a debit to cash of the moneys received, and a like credit to Debentures Account recording the receipt of a new loan in place of the old one discharged. If no cash passes, however, debit the old Debenture Account and credit the new.

Sometimes an entire issue of debentures is redeemed in order to make a fresh issue on more favourable terms.

Illustration.—Soleil d'Or, Ltd., decided to redeem its issue of £50,000 6 % debentures repayable in 19.. for a fresh issue of 5 % debentures for a longer term. The debenture holders were given the option of converting their holdings to the new issue. The offer was accepted, the old bonds were called in and cancelled, and fresh bonds were issued for the new loan.

The old Debenture Account will be closed, and the new account be opened by the following entry :—

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			DR. £	s.	d.	CR. £	s.	d.
19... Dec. 31	6 % Debentures Account .. .. Dr.		50,000	0	0			
	To 5 % Debentures Account					50,000	0	0
	Being cancellation of the old series 1–500 and the issue, in exchange, of the new series 501–1000.							

The changes effected must be notified to the Registrar and be recorded in the Register of Charges.

EXAMINATION QUESTION

A company raises a loan of £500,000 upon Debenture Stock, at a discount of 2½ % on 1st January, 19.. (year 1). The loan is redeemable at par at the end of a period of years, by a cumulative Sinking Fund, but the Company has power to call upon the Trustees to apply the Sinking Fund Investments in the purchase of stock, if below par, at any time. The annual sinking fund contribution, exclusive of interest accumulated, is £12,000 This amount is promptly invested, together with income accumulations, on 1st January in each year; capital balances arising from realisation of investments are reinvested at the same time. The Sinking Fund instalments are calculated on a 3 % basis, but are invested to give a higher yield.

Sinking Fund Investments produce interest, less tax, as follows:—

Year 2, £394; Year 3, £608; Year 4, £718.

Realisations of Sinking Fund Investments are as follows:—

	£	s.	d.		£	s.	d.
30th June, Year 2 ..	4,306	5	0	Original cost	4,292	10	0
30th Sept., Year 2 ..	1,280	6	0	Original cost	1,310	0	0
31st August, Year 3 ..	8,340	0	0	Original cost	8,307	10	0
31st March, Year 4 ..	6,180	0	0	Original cost	6,160	0	0

The proceeds of realisations are applied in redemption of Stock as follows:—

	£		£
31st July, Year 2	4,305	In cancellation of ..	4,563 Stock.
31st October, Year 2	1,278	In cancellation of ..	1,300 Stock.
30th September, Year 3 ..	8,340	In cancellation of ..	8,360 Stock.
30th April, Year 4	6,175	In cancellation of ..	6,200 Stock.

Interest is paid on the Loan half yearly on 1st July and 1st January.

Prepare accounts in respect of the Sinking Fund transactions given for the years 1 to 4 inclusive, showing the manner in which the Sinking Fund would be compensated for the loss of interest resulting from the realisation of investments. State also how you would deal with the accounts relating to Discount on Issue, Profit on cancellation of Stock, and Profit and Loss on realisation of Investments (*Chartered Accountants*).

For *Solution* see pp. 404–408.

Debentures Deposited to Secure Advances.—Not infrequently debentures are issued to a loan creditor, usually the company's bankers, as security for the loan. The nominal value of the debentures deposited generally exceeds the amount of the loan by a margin of from 10 % to 15 %. In the author's experience, examination candidates frequently err when dealing with an issue of this kind. The simple facts are these: The liability of the company is the amount of the loan, and *not the face value of the debentures*. The debentures are not an ordinary issue for which cash has been subscribed; they are merely issued as additional security for the loan, and are a *contingent liability only*. If the company defaults, the loan creditor can exercise whatever powers the debentures confer upon him, in order to protect himself, and he can, in the event

Solution

DEBENTURE STOCK ACCOUNT

Dr.		£	s.	d.		Cr.	£	s.	d.
Year 2 July 31	To Cash	4,305	0	0	Year 1 Jan 1	By Sundries	500,000	0	0
	,, Profit and Loss on Cancellation of Debentures Account	258	0	0					
Oct. 31	,, Cash	1,278	0	0					
	,, Profit and Loss on Cancellation of Debentures Account	22	0	0					
Dec. 31	,, Balance carried down	494,137	0	0					
	£	500,000	0	0		£	500,000	0	0
Year 3 Sept. 30	To Cash	8,340	0	0	Year 3 Jan. 1	By Balance brought down	494,137	0	0
	,, Profit and Loss on Cancellation of Debentures Account	20	0	0					
	,, Balance carried down	485,777	0	0					
	£	494,137	0	0		£	494,137	0	0
Year 4 April 28	To Cash	6,175	0	0	Year 4 Jan. 1	By Balance brought down	485,777	0	0
	,, Profit and Loss on Cancellation of Debentures Account	25	0	0					
Dec 31	,, Balance carried down	479,577	0	0					
	£	485,777	0	0		£	485,777	0	0
					Year 5 Jan. 1	By Balance brought down £	479,577	0	0

SINKING FUND ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
Year 2 Dec. 31	To Profit and Loss on Realisation of Investments Account	15	19	0	Year 1 Dec. 31	By Profit and Loss (Appropriation) Account	12,000	0	0
	,, General Reserve	5,863	0	0	Year 2 Dec. 31	By Profit and Loss (Appropriation) Account	12,000	0	0
	,, Balance carried down	18,795	1	0		,, Interest on Investments	394	0	0
						,, Profit and Loss on Cancellation of Debentures Account	280	0	0
		£24,674	0	0			£24,674	0	0
Year 3 Dec. 31	To General Reserve	8,360	0	0	Year 3 Jan. 1	By Balance brought down	18,795	1	0
	,, Balance carried down	23,095	11	0	Dec. 31	,, Profit and Loss on Cancellation of Debentures Account	20	0	0
						,, Profit and Loss on Realisation of Investments Account	32	10	0
						,, Interest on Investments	608	0	0
						,, Profit and Loss Account	12,000	0	0
		£31,455	11	0			£31,455	11	0
Year 4 Dec. 31	To General Reserve	6,200	0	0	Year 4 Jan. 1	By Balance brought down	23,095	11	0
	,, Balance carried down	29,658	11	0	Dec. 31	,, Profit and Loss on Cancellation of Debentures Account	25	0	0
						,, Profit and Loss on Realisation of Investments Account	20	0	0
						,, Interest on Investments Account	718	0	0
						,, Profit and Loss Account	12,000	0	0
		£35,858	11	0			£35,858	11	0
					Year 5 Jan. 1	By Balance brought down	29,658	11	0

SINKING FUND INVESTMENTS ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
Year 2		£	s.	d.	Year 2		£	s.	d.
Jan. 1	To Cash, purchase of investments	12,000	0	0	June 30	By Cash, realisation	4,306	5	0
June 30	,, Profit and Loss on Realisation of Investments Account	13	15	0	Sept. 30	,, Cash, realisation	1,280	6	0
						,, Profit and Loss on Realisation of Investments Account	29	14	0
					Dec. 31	,, Balance carried down	6,397	10	0
		£12,013	15	0			£12,013	15	0
Year 3		£	s.	d	Year 3		£	s.	d.
Jan. 1	To Balance brought down	6,397	10	0	Aug. 31	By Cash, realisation	8,340	0	0
	,, Cash, purchase of Investments—				Dec 31	,, Balance carried down..	10,487	11	0
	Appropriation 12,000 0 0								
	Interest 394 0 0								
	Balance of Investments sold .. 3 11 0	12,397	11	0					
		18,795	1	0					
Aug. 31	,, Profit and Loss on Realisation of Investments Account	32	10	0					
		£18,827	11	0			£18,827	11	0
Year 4		£	s	d.	Year 4		£	s.	d.
Jan. 1	To Balance brought down	10,487	11	0	Mch. 31	By Cash, realisation	6,180	0	0
	,, Cash, purchase of Investments—				Dec. 31	,, Balance carried down	16,935	11	0
	Appropriation 12,000 0 0								
	Interest 608 0 0	12,608	0	0					
		23,095	11	0					
Mch. 31	,, Profit and Loss on Realisation of Investments Account	20	0	0					
		£23,115	11	0			£23,115	11	0

Date	Particulars		£	s.	d.	Date	Particulars	£	s.	d.
Year 5 Jan. 1	To Balance brought down		16,935	11	0					
	„ Cash, purchase of Investments—									
	Appropriation	12,000 0 0								
	Interest	718 0 0								
	Balance of Investments sold	5 0 0								
			12,723	0	0					
			29,658	11	0					

PROFIT AND LOSS ON REALISATION OF INVESTMENTS ACCOUNT.

Dr. Cr.

Date	Particulars	£	s.	d.	Date	Particulars	£	s.	d.
Year 2 Sept. 30	To Sinking Fund Investments Account	29	14	0	Year 2 June 30	By Sinking Fund Investments Account	13	15	0
					Dec. 31	„ Sinking Fund Account	15	19	0
		£29	14	0			£29	14	0
Year 3 Dec. 31	To Sinking Fund Account	£32	10	0	Year 3 Aug. 31	By Sinking Fund Investments Account	£32	10	0
Year 4 Dec. 31	To Sinking Fund Account	£20	0	0	Year 4 Mch. 31	By Sinking Fund Investments Account	£20	0	0

PROFIT AND LOSS ON CANCELLATION OF DEBENTURES ACCOUNT.

Dr. Cr.

Date	Particulars	£	s.	d.	Date	Particulars	£	s.	d.
Year 2 Dec. 31	To Sinking Fund Account	280	0	0	Year 2 July 31	By Debenture Stock Account	258	0	0
					Oct. 31	„ Debenture Stock Account	22	0	0
		£280	0	0			£280	0	0

PROFIT AND LOSS ON CANCELLATION OF DEBENTURES ACCOUNT—*continued.*

Dr.		£	s.	d.	Cr.		£	s.	d.
Year 3 Dec. 31	To Sinking Fund Account	£20	0	0	Year 3 Sept. 30	By Debenture Stock Account	£20	0	0
Year 4 Dec 31	To Sinking Fund Account	£25	0	0	Year 4 April 28	By Debenture Stock Account	£25	0	0

GENERAL RESERVE ACCOUNT.

Dr.		£	s.	d.	Cr.		£	s.	d.
Year 2 Dec. 31	To Discount on Debentures Account	£5,863	0	0	Year 2 Dec. 31	By Sinking Fund Account	£5,863	0	0
Year 3 Dec. 31	To Discount on Debentures Account	6,637	0	0	Year 3 Dec. 31	By Sinking Fund Account	8,360	0	0
	„ Balance carried down	1,723	0	0					
		£8,360	0	0			£8,360	0	0
Year 4 Dec. 31	To Balance carried down	7,923	0	0	Year 4 Jan. 1	By Balance brought down	1,723	0	0
					Dec. 31	„ Sinking Fund Account	6,200	0	0
		£7,923	0	0			£7,923	0	0
					Year 5 Jan. 1	By Balance brought down	£7,923	0	0

NOTE.—It is the better practice to transfer each year to General Reserve a proportion of the Sinking Fund equal to the proportion of the Debenture Stock cancelled, as the Fund has to that extent been utilised for the purpose for which it was created. It is desirable to write off the Debenture Discount against the amounts so transferred, in order to eliminate the fictitious asset.

There is no need to compensate the Sinking Fund *for loss of interest on the investments realised*, as *debentures have been cancelled therewith*. It will, however, be necessary to recompute the Sinking Fund yearly allocations. Alternatively, the Debentures redeemed can be treated as investments on Sinking Fund Account, and a transfer be made each year from Profit and Loss Account to Sinking Fund Account of the interest of such debentures, an equivalent amount of cash being invested on the Fund Account.

of insolvency, claim a dividend on the deposited debentures *pari passu* with other debentures of the series until his loan is paid in full. A note should be made under the heading of the loan ledger account giving particulars of the debentures issued as security. The only other record necessary is a note in the Balance Sheet as under :—

BALANCE SHEET
(LIABILITIES SIDE.)

Loan from Bankers .. .. (Secured by the issue of £11,000 5 % debentures.)	£10,000

If the loan is paid off, the debentures are not held to be redeemed. They are still available for issue, but may be left on deposit and used to cover future loans (*see* p. 312).

Balance Sheet and Debentures.—The facts that the Balance Sheet should disclose regarding debentures are as follows :—

(*a*) The amount originally issued, and the redemptions (if any) to date.

(*b*) If issued at a premium, the way the premium has been dealt with, i.e. treated as a capital reserve, or as ordinary revenue.

(*c*) If issued at a discount, the total amount of the discount, the amount written off to date, and the amount of the annual instalments.

(*d*) Whether redemption of the debentures is being provided for, and, if so, how.

(*e*) That the debentures have been issued as additional security; if such be the fact, the issue should be entered "short" under the liability secured.

(*f*) Whether all accrued interest has been brought into account.

(*g*) The expenses of issue, and the amount written off to date (S. 124).

If the company has power to re-issue debentures which have been redeemed, particulars with respect to the debentures which can be so re-issued *must* be included in every Balance Sheet (S. 75 [3]).

Statutory Report.—Every company limited by shares, and every company limited by guarantee and having a share capital must, unless it is a private company, hold a general meeting of its members, not less than one month, or more than three months, from the date on which it is entitled to commence business (S. 113). This meeting is called the *Statutory Meeting*. At least seven days before the meeting, a report, known as the *Statutory Report*, must be sent to every member of the company (S. 113 [2]). The Report must be certified by not less than two directors of the company, or, where there are less than two, by the sole director and manager (S. 113 [3]). If this meeting be not held, then, fourteen days after the date on which it should have been held, any shareholder may apply to the Court to have the company wound up (Ss. 168 and 170). But the Court may

direct that the meeting shall be held (S. 171 [2]). A copy of the Report must be filed with the Registrar (S. 113 [5]. The Statutory Meeting is not an ordinary general meeting within the meaning of S. 112, and, therefore, no Annual Return need be filed for this meeting. None of these provisions apply to a Private Company (S. 113 [10]).

Statutory Report.—By S. 113, ss. 3, the Report must furnish the following information:—

(*a*) The total number of shares allotted, distinguishing those allotted as fully, or partly, paid up otherwise than in cash, the extent to which they are so paid up and the consideration therefor.

(*b*) The total amount of cash received by the company in respect of all the shares allotted, distinguished as in (*a*).

(*c*) An abstract of the receipts of the Company and of the payments made from those receipts up to a date within seven days of the date of the report, distinguishing receipts from shares and debentures and those from other sources, the payments made thereout, and particulars of the balance remaining in hand, and

(*d*) An account or estimate of the preliminary expenses.

(*e*) The names, addresses, and descriptions of the Directors, Auditors (if any), Managers (if any), and Secretary of the company.

(*f*) Particulars of any contract the terms of which it is proposed to modify together with particulars of the proposed modification. By S. 36 a public company may not previously to the statutory meeting vary the terms of a contract referred to in the Prospectus or Statement in Lieu except subject to the approval of that meeting.

The Report must be certified by the auditors (if any) (*a*) so far as it relates to the shares allotted by the company; (*b*) as to the cash received in respect of such shares; and (*c*) as to the receipts and payments on capital account (S. 113, ss. 4).

A list of members, giving their names, addresses, descriptions, and shareholdings must lie on the table at the meeting for inspection (S. 113, ss. 6).

Statutory meetings are usually brief and formal, and frequently futile. But they afford members an opportunity to ask questions relating to the promotion and formation of the company. But no resolution may be passed notice of which has not been given in accordance with the Articles (S. 113, ss. 7).

Illustration.—Soleil d'Or, Ltd., was formed to acquire an existing business, and was registered with a nominal capital of 100,000 ordinary shares of £1 each. The vendors received 10,000 shares as part payment of sundry assets purchased, and 40,000 shares were allotted to the public. The shares were fully paid up with the exception of calls amounting to £500 outstanding on three allotments. The preliminary expenses were estimated at £4,000. The trading receipts and payments were £10,321 and £9,670 respectively. £25,000 had been paid to the vendors in

accordance with the purchase agreement. The bank balance was £11,971. The Statutory Report in proper form recording this position is given below.

Number of Company, 365.

THE COMPANIES ACT, 1920

REPORT (Pursuant to Section 113 of The Companies Act, 1929)

OF

.... Limited.

A Companies Registration Fee Stamp of 5s. must be *impressed* here.

To be certified by not less than two Directors, and forwarded at least seven days before the Statutory Meeting to every Member of the Company, and to be delivered to the Registrar of Companies for registration forthwith after it is so forwarded—Section 113 of The Companies Act, 1929.

NOTE.—This form has been provided for the purpose of indicating the nature of the information that is required; but as the Report to be filed must be a copy of that sent to the Shareholders, all that is contained in that Report must appear in this. (This is not on an official form. Blank forms cannot be obtained from the Registrar of Companies as is the case with official forms such as the Annual Return.)

(*a*) The Total Number of Shares allotted is 50,000 *Ordinary Shares of £1 each*, of which 10,000 *Shares* are allotted* *as fully paid up* in consideration of *part of the purchase price of sundry assets acquired by the company*, and upon each of the remaining Shares the sum of *£1* has been paid in Cash.

(*b*) The Total Amount of Cash received by the Company in respect of the Shares allotted wholly for Cash is £39,500, and on the Shares allotted partly for Cash is £(*nil*).

(*c*) The Receipts and Payments of the Company made thereout to the 10*th* day of *October*, 19.., are as follows:—

Particulars of Receipts.	£	s.	d.	Particulars of Payments.	£	s.	d.
Amount received on 40,000 Ordinary Shares issued for Cash .	*39,500*	*0*	*0*	*Payments to Vendors in respect of purchase of Land, Buildings, and Machinery*	*25,000*	*0*	*0*
Trading receipts	*10,321*	*0*	*0*	*Preliminary Expenses* . ..	*3,180*	*0*	*0*
				Trading payments	*9,670*	*0*	*0*
				Balance at Bank	*11,971*	*0*	*0*
	£49,821	*0*	*0*		*£49,821*	*0*	*0*

* Here state as "fully paid up" or "paid up otherwise than in cash to the extent of .... per share."

The following is an account (or estimate) of the Preliminary Expense of the Company.

	£	s.	d
Cost of registration of the Company, underwriting commission, law costs, brokerage, printing and advertising, etc., estimated at	*4,000*	*0*	*0*

(*d*) Names, Addresses, and Descriptions of the Directors, Auditors (if any), Manager (if any), and Secretary of the Company.

Surname.	Christian Name.	Address.	Description.
		DIRECTORS.	
MacArthur	*George*	*16 Finsbury Circus, London, E.C.*	*Chartered Accountant*
Goodwin	*Arthur*	*Eastwood, Essex*	*Rose Grower*
Ducher	*Pernet*	*Lyons, Rhône, France*	*Horticulturist*
		AUDITORS.	
Accurate & Co.	—	*Salisbury House, London, E.C.*	*Chartered Accountants*
		MANAGER.	
Richmond	*Robert*	*Rochford, Essex*	*Rose Grower*
		SECRETARY.	
Dixon	*Hugh*	*Rochford, Essex*	*Incorporated Accountant*

(*e*) Particulars of any Contract the modification of which is to be submitted to the Meeting for its approval, together with the particulars of the modification or proposed modification.

The contract set out in the prospectus, and dated July 5, 19.., whereby the services of Robert Richmond were to be secured to the Company for a period of ten years is to be submitted to the meeting with a view to the reduction of the term of years from ten to five.

WE hereby certify this Report.

George MacArthur } Two
Arthur Goodwin } Directors.

WE hereby certify that so much of this Report as relates to the shares allotted by the Company and to the Cash received in respect of such shares and to the receipts and payments of the Company on Capital Account is correct.

Accurate & Co.,
Auditors.

Dated the *10th* day of *October, 19...*

Preliminary Expenses.—An estimate of the preliminary expenses (see p. 412) must be given in the Statutory Report, but no details need be disclosed. A separate account must be opened and debited with all items chargeable to preliminary expenses. If the vendor undertakes to pay all expenses up to allotment, the account is a personal account as against the vendor. If the promoter is liable for Preliminary Expenses, particular care is necessary that all legitimate expenses are charged to his account. To this end it is useful to add an extra column in the Cash Book for the accommodation of these charges. If the company bears the cost of the formation or promotion expenses, it is legitimate to " hold up " the expenditure as a temporary asset to be written off in instalments spread over from three to five years. The preliminary expenses must be stated under a separate heading on the Balance Sheet, so far as they are not written off (S. 124 [2(*a*)]). Any expenses of a share issue must be similarly stated (S. 124 [2(*b*)]). The position should be clearly shown in the Balance Sheet thus:—

BALANCE SHEET.

(ASSETS SIDE.)

	£	£
Preliminary Expenses Account	7,863	
Less One-third written off this year	2,621	
		5,242

Inasmuch as the company could not have been formed without expenditure of this kind, it is reasonable to treat the outlay as temporary capital expenditure spread over a period of years. Legal sanction for this treatment is afforded by the case of *Bale* v. *Cleland*. Instalments written off preliminary expenses are not allowed as a deduction for income tax, the Revenue authorities claiming that it is capital expenditure. Actual purchases, e.g. the seal, stationery, account books, etc., are, however, allowed. It is a growing modern practice to contract with a promoting syndicate for the formation of the company, and the underwriting of its capital for an inclusive fee.

Splitting Shares.—Limited companies, if so authorised by their Articles. have power to sub-divide, or " split " their shares into shares of smaller denomination than that fixed by the Memorandum of Association (S. 50, ss. 1 [*d*]). Not infrequently, prosperous companies, whose capital was originally issued in shares of large denomination, find the market for their shares hampered by that fact, and therefore take advantage of the power conferred by this section to alter their Memorandum, and so to split their shares, e.g. from £10 to £1 per share.

Examination candidates appear to be at a loss when confronted by an operation of this kind. The process of splitting shares is both costly

and tiresome, but the financial entry involved is of the simplest, viz. a transfer from the old capital account to the new capital account.

Illustration.—Uprichards, Ltd., was registered with a nominal capital of 50,000 shares of £10 each, of which 30,000 shares were subscribed and fully paid up. The company was very successful, but found that the market for the shares was restricted owing to their high denomination. A resolution was passed on December 31, 19.., subdividing each £10 share into ten shares of £1 each. The old certificates were called in and exchanged for the new, and the necessary alterations were made in the Share Ledger. The only entry necessary in the financial books is as follows:—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Ordinary Shares (£10) Account .. .. Dr.		300,000	0	0			
	To Ordinary Shares (£1) Account					300,000	0	0
	Being the conversion of the old ordinary share capital of 30,000 shares of £10 each, into new ordinary shares of £1 each as per special resolution, dated December 31, 19..							

EXAMINATION QUESTION.

On December 31, 19.., the North and South Colliery Company, Ltd., had Ordinary Share Capital, authorised and fully subscribed, of £200,000, in shares of £10 each, and a General Reserve of £150,000. During 19.. the capital was increased by £100,000, in new shares of £1 each; and the original shares were converted into shares of £1 each. Resolutions were duly passed, whereby £100,000 of the Reserve was distributed to the ordinary shareholders as bonus, and was applied in satisfaction of new shares issued to the shareholders at par. Set out the Journal entries and the accounts in full recording the foregoing transactions, and the information, in respect thereof, which should appear on the Balance Sheet of the company as on December 31, 19... (*Chartered Accountants.*)

Solution

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Ordinary Share Capital Account (£10 shares) Dr.	1	200,000	0	0			
	To Ordinary Share Capital (£1 shares) ..	3				200,000	0	0
	Being transfer of the former account to the new Share Capital (£1 shares) Account.							
" 31	Reserve Account .. .. Dr.	5	100,000	0	0			
	To Bonus Dividend Account..	7				100,000	0	0
	Being Bonus declared from Reserve as per resolution dated....							
" 31	Bonus Dividend Account .. .. Dr.	7	100,000	0	0			
	To Ordinary Share Capital (£1 shares) Account	9				100,000	0	0
	Being transfer of the former account in satisfaction of 100,000 shares of £1 each allotted as per resolution dated....							

LEDGER.

1 Ordinary Share Capital (£10 Shares) Account. 1

Dr. Cr.

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Ordinary Share Capital (£1 shares) Account	14	200,000	0	0	19... Dec. 31	By Balance	√	200,000	0	0

3 Ordinary Share Capital (£1 Shares) Account. 3

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
						19... Dec. 31	By Ordinary Share Capital (£10 shares) Account	14	200,000	0	0
						" 31	" Bonus Dividend Account	14	100,000	0	0
								£	300,000	0	0

5 Reserve Account. 5

Dr. Cr.

		J.	£	s.	d				£	s.	d.
19... Dec. 31	To Bonus Dividend Account	14	100,000	0	0	19.. Dec. 31	By Balance	√	150,000	0	0
" 31	" Balance carried down	√	50,000	0	0						
		£	150,000	0	0			£	150,000	0	0
						19... Dec. 31	By Balance brought down	√	50,000	0	0

7 Bonus Dividend Account. 7

Dr. Cr.

		J.	£	s.	d.			J.	£	s.	d.
19 .. Dec 31	To Ordinary Share Capital (£1 shares) Account	14	100,000	0	0	19... Dec. 31	By Reserve Account	14	100,000	0	0

North and South Colliery Company, Limited.

BALANCE SHEET, DECEMBER 31, 19...

(Liabilities Side Only.)

	£ s. d.	£	s.	d.
Capital :— *Nominal:* 300,000 Ordinary Shares of £1 each	300,000 0 0			
Issued: 300,000 Ordinary Shares of £1 each, fully paid		300,000	0	0
Reserve Account		50,000	0	0

Conversion of Shares into Stock.—The characteristics of stock, and the reasons for the conversion of shares into stock, were explained on p. 303. As is the case when shares are "split," considerable office

work is entailed when converting shares into stock. The old certificates must be called in and exchanged for the new stock certificates, and the necessary schedules must be prepared and carefully checked to ensure accuracy in carrying out the conversion. As has already been stated, commercial companies usually restrict transfers of stock to a round sum, £1 or £5, etc., but Government stocks can usually be transferred in fractional amounts, e.g. £101 19s. 6d.

Companies are under no obligation to convert the whole of their fully paid shares into stock. They may convert a portion only, the remainder being left as originally issued.

Illustration.—Uprichards, Ltd., decided to convert their 8 % Preference Share Capital of £200,000 into 8 % stock of similar amount. The resolution authorising this was passed on July 2, 19.., and due notice was sent to the Registrar. The old certificates were called in, new stock certificates were issued, and the necessary alterations were made in the Share Ledger. The only entry required in the financial books is as follows:—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... July 2	8 % Preference Share Capital Account .. Dr.		200,000	0	0			
	To 8 % Preference Stock Account					200,000	0	0
	Being the conversion of 200,000 8 % Preference Shares of £1 each into 8% Preference Stock as per special resolution passed this day.							

Interest Paid Out of Capital.—A limited company must pay interest to its creditors, e.g. on debentures, loans, etc., whether or not there are profits available. If profits are not available, the interest must be paid out of capital. It may not pay dividends out of capital, since that would amount to a return of capital, which is illegal, except as laid down by Statute. But in certain circumstances, a company may pay *interest* to its shareholders out of capital. Companies formed for the purpose of constructing works, or providing plant, which, during the long period of construction, will be unproductive of revenue, may pay interest on the paid-up capital raised for that purpose, and may capitalise that interest as part of the cost of construction, subject to the following conditions:—

(1) Such payments must be authorised by the Articles, or by special resolution.

(2) They must also be authorised by the Board of Trade.

(3) The Board of Trade may hold an enquiry at the company's expense prior to giving its assent, and may require security for the costs of the enquiry.

(4) The payments may only be made for the period determined by the Board, and may in no case extend beyond the close of the half-year next following the half-year during which the works were actually completed or the plant provided.

(5) The rate of interest must in no case exceed 4 % per annum, or such other rate as may be prescribed from time to time by Order in Council. *The Companies (Interest out of Capital) Order*, 1929, fixed the rate at a maximum of 6 % per annum.

(6) The payment of interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid.

(7) The accounts of the company must show the share capital on which, and the rate at which, interest has been paid out of capital during the period to which the accounts relate (S. 54).

Similar powers are sometimes granted to Parliamentary Companies, e.g. Dock, Railway, Harbour, and Canal Companies.

The student will realise that the principle of allowing interest to be paid and charged to capital in such cases is perfectly reasonable. Capital expenditure over a long period must perforce involve the question of interest as an additional cost. If the work were undertaken by an independent contractor he would, of course, take interest into account when preparing the estimates on which to base his tender. The final cost of construction work is made up of the cost of machinery, materials, labour, supervision, and establishment charges, *plus* interest on the capital employed, which, but for its employment in that way, would be invested in good securities, paying a reasonable rate of interest.

The allocation of the interest paid as between the various assets created needs careful consideration, and should be based as far as possible on the actual capital employed in constructing each particular asset.

Interest on sums paid in advance of calls can also be paid out of capital if no profits are available.

Balancing the Share Register.—Prior to the payment of a dividend, it is necessary to balance the Share Register. This is an important operation in the case of a large company whose shares are freely dealt in. The holdings entered on the lists as entitled to dividends must, of course, tally with the total issued capital of the company.

TRANSFER POSTINGS JOURNAL.

Shares Transferred.	Transferees.				Transferors.			
	Registers.				Registers.			
	1	2	3	4	1	2	3	4
100		100					100	
75			75					75
50	50						50	
225	50	100	75				150	75

The Share Ledgers having been closed (*see* p. 319) the first step is to check all transfers and to take out a "trial balance." Only the "folio" and "balance" of shares held by each member are extracted, and the sum of these balances must agree with the total of the share capital held. When several Registers are employed, it is usual to adapt the self-balancing principle to the Share Registers. For this purpose a *Transfer Postings Journal* is employed, as shown on p. 417.

This book function as a tabular journal forming part of a system of self-balancing books, and can be conveniently kept on the "loose-leaf" principle.

Illustration.—Uprichards, Ltd., has an issued capital of 200,000 ordinary shares of £1 each. Four registers are kept containing particulars of holdings as under :—

	Shares.
No. 1 Register	56,000
No. 2 Register	44,000
No. 3 Register	85,000
No. 4 Register	15,000
	200,000

The above totals give us the starting-point for the Adjustment Account, which will be completed by adding or subtracting the totals shown in the Transfer Postings Journal as follows :—

ORDINARY SHARES ADJUSTMENT ACCOUNT.

	Registers.				Totals.
	No. 1.	No 2.	No. 3.	No. 4.	
Balances	56,000	44,000	85,000	15,000	200,000
Add Transferee's Postings	50	100	75		225
	56,050	44,100	85,075	15,000	200,225
Deduct Transferor's Postings			150	75	225
	56,050	44,100	84,925	14,925	200,000

The balances extracted from the four registers for the purpose of preparing the list of holdings entitled to dividend on the date when the registers were closed should agree with the Adjustment Account as prepared above. If they fail to agree, it will be seen in which register the error is located.

Increase of Capital.—The nominal capital of a company as fixed be its Memorandum cannot be increased except under the power conferred by S. 50, and then only if the Articles sanction an increase. If the Articles do not authorise an increase, they must be altered, by special resolution, to give the required power. Articles, almost invari-

ably, take power to increase the registered capital, and frequently require a special resolution to exercise it, but, if the Articles so provide, an ordinary resolution will suffice. The matter cannot be left to the discretion of the directors since S. 50[2] provides that the power must be exercised by the company in general meeting. Increases of capital are quite frequent, and are usually made for the purpose of acquiring or absorbing other companies, or for purchasing similar businesses, or to provide additional working capital for development of the company's own business. Notice of any increase effected must be sent to the Registrar within fifteen days, and *ad valorem* duty must be paid on the new capital.

The book-keeping records for the issue of this increased capital are precisely similar to those required for an original issue of shares. Separate banking accounts and Cash Books should be opened for each class of share, if more than one class has been included in the increase. It is usual to open a temporary "New Ordinary Share Account," etc., to which the various Application, Allotment, and Call Moneys are credited. When the issue is complete, and the shares fully paid, the Account is closed by Transfer to the original Share Capital Account as follows :—

NEW ORDINARY SHARE CAPITAL ACCOUNT.

(Issue of 100,000 New Ordinary Shares authorised by Special Resolution dated June 30, 19...)

Dr. Cr.

19...		P.L.	£	s.	d.	19..				£	s.	d.
Sept. 5	To Transfer to Ordinary Share Capital Account	56	100,000	0	0	July 1	By Application and Allotment Account ..	2		50,000	0	0
						Aug. 1	,, First Call Account	3		25,000	0	0
						Sept. 1	,, Final Call Account	5		25,000	0	0
		£	100,000	0	0				£	100,000	0	0

ORDINARY SHARE CAPITAL ACCOUNT.

Dr. Cr.

			£	s.	d.	19...				£	s.	d.
						July 1	By Balance.. ..	√		150,000	0	0
						Sept. 5	,, Transfer from New Ordinary Share Capital Account ..	P.L. 87		100,000	0	0
									£	250,000	0	0

The various expenses connected with an increase of capital should be posted to an account headed "New Issue Expenses Account," and may, if so desired, be written off within a reasonable term, as was explained in connection with preliminary expenses. The balance of

this account must appear under a separate heading on the Balance Sheet until written off (S. 124).

Reduction of Capital.—It becomes advisable in certain circumstances to reduce the capital of a limited company. Trading losses may have been incurred with the consequence that a heavy balance stands to the debit of Profit and Loss Account, and the declaration of dividends on the existing capital is made improbable, even should the tide of fortune begin to turn. Depreciation of assets may have occurred which render their book values untenable. In such, and similar, events, it is obvious that the company has become over-capitalised, and should adjust its capital to the altered circumstances, in order to attain some reasonable relation between its capital and assets, and so to re-adjust matters that dividends may be paid and the market value of its shares be re-established. We have already seen that supreme importance is attached by the Legislature to the obligation of a company to keep its capital intact. In the circumstances described above a private trader would meet the case by transfers to the debit of his Capital Account. But a limited company has no such power and can only reduce its capital in statutory manner. Section 55 provides for a reduction of capital in any way, and in particular:—

(*a*) By extinguishing or reducing the liability on any of its shares not paid up.

(*b*) By cancelling paid-up capital which has been lost or is unrepresented by available assets.

(*c*) By returning to its shareholders capital proved to be in excess of the company's wants.

The majority of Articles give power to reduce capital in the three ways specified above. If Articles do not so empower, they must be altered by special resolution, so as to confer the power. To effect the reduction a special resolution must be passed, and this must be confirmed by the Court. Reductions of capital for reasons other than those given in (*b*) above are so rare that they need not be considered here.

The order of the Court when issued together with a minute approved by the Court showing the capital as altered, viz., the amount, number of shares into which it is to be divided, the amount of each share, and the amount now deemed to be paid up thereon, must be filed with the Registrar and published as the Court may direct, and a copy must be added to every copy of the Memorandum and Articles. The Court may order that the words "and reduced" must be added to the name of the company, for so long as the Court directs.

Under a scheme of reduction the existing shares can be reduced in nominal value to any desired extent, but a member, past or present, shall not be liable, in respect of any share to any call or contribution exceeding in amount the difference, if any, between the amount of the share as fixed by the minute approved by the Court and the amount

paid, or the reduced amount, if any, which is deemed to have been paid, on the share, as the case may be (S. 59). (This must be read in conjunction with S. 22, which provides that no member shall be bound by any alteration made in the memorandum or articles which in any way increases his liability to contribute to the share capital, unless he agrees in writing to be bound thereby.) If, therefore, a company which is reducing its capital desires at the same time to raise additional funds, it must do so by a fresh issue which would, in these circumstances, probably take the form of Preference Shares, or Debentures. As an alternative, a new company consisting of the old shareholders could be formed, with re-adjusted capital rights, to purchase the property of the old company (S. 234).

The old share certificates must be called in to be cancelled, or indorsed, and the Register of Members must be amended to record the new conditions.

The method of recording capital reductions in book-keeping terms may be demonstrated by the following simple illustration :—

Illustration.—Blanks, Ltd., decided to reduce their capital of 100,000 shares of £1 each to 100,000 shares of 10s. each. It was further decided to utilise the reduction as follows : To write off Goodwill Account, £20,000 ; to reduce Machinery and Plant Account to £20,000 ; and to write off the debit balance of Profit and Loss Account, £20,000. At the date of the proposed reduction, the Balance Sheet of the Company was as follows :—

Blanks, Limited.

BALANCE SHEET, DECEMBER 31, 19...

		s.	d.		£	s.	d.
Issued Capital :—100,000 shares of £1 each, fully paid	100,000	0	0	Goodwill	20,000	0	0
Sundry Creditors	40,200	0	0	Machinery and Plant	30,000	0	0
				Sundry Assets	69,800	0	0
				Cash	400	0	0
				Profit and Loss Account	20,000	0	0
£	140,200	0	0	£	140,200	0	0

The decisions arrived at as stated above may be expressed by the following Journal entry :—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Share Capital Account .. .. Dr.		50,000	0	0			
	To Reduction of Capital Account					50,000	0	0
	Being the reduction of 100,000 shares of £1 each to shares of 10s. each.							
" 31	Reduction of Capital Account .. .. .. Dr.		50,000	0	0			
	To Sundry Assets :—							
	Goodwill					20,000	0	0
	Machinery and Plant					10,000	0	0
	Profit and Loss Account					20,000	0	0
	Being the elimination or reduction of the above accounts.							

[*Continued on p.* 423.

Rayon d'Or, Limited.

BALANCE SHEET, DECEMBER 31, 19...

	£ s. d.	£	s.	d.
Capital:—				
Nominal—				
50,000 5 % Cumulative 1st Preference Shares of £1 each	50,000 0 0			
100,000 7 % Non-Cumulative 2nd Preference Shares of £1 each ..	100,000 0 0			
100,000 Ordinary Shares of £1 each	100,000 0 0			
	£250,000 0 0			
Issued—				
50,000 5 % Cumulative 1st Preference Shares of £1 each	50,000 0 0			
80,000 7 % Non-Cumulative 2nd Preference Shares of £1 each ..	80,000 0 0			
80,000 Ordinary Shares of £1 each	80,000 0 0			
		210,000	0	0
Debentures: 200 4½ % Debentures of £100 each		20,000	0	0
Sundry Creditors		32,869	0	0
Bank Loan		11,762	0	0
Reserve Account		3,000	0	0
£		277,631	0	0

	£	s.	d.
Leasehold Factory	100,896	0	0
Patents Account	30,000	0	0
Machinery and Plant	52,785	0	0
Stock	38,898	0	0
Sundry Debtors	29,776	0	0
Debenture Issue Expenses Account ..	2,780	0	0
Cash at Bank (Current Account)	1,784	0	0
Profit and Loss Account (Balance)	20,712	0	0
£	277,631	0	0

10 REDUCTION OF CAPITAL ACCOUNT. 10

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Sundry Assets:				19... Dec. 31	By Share Capital Account	50,000	0	0
	Goodwill ..	20,000	0	0					
	Machinery and Plant	10,000	0	0					
	Profit and Loss Account	20,000	0	0					
	£	50,000	0	0		£	50,000	0	0

The remaining ledger accounts need not be illustrated. The readjusted Balance Sheet of the Company would appear as follows:—

Blanks, Ltd. (and Reduced).*

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Issued Capital:—				Machinery and Plant	20,000	0	0
100,000 shares of 10s. each, fully paid	50,000	0	0	Sundry Assets	69,800	0	0
Sundry Creditors	40,200	0	0	Cash	400	0	0
£	90,200	0	0	£	90,200	0	0

If this Balance Sheet were to be laid before a General Meeting, the basis of valuation of the Fixed Assets would have to be shown, e.g. "at cost, less depreciation and amounts written off by order of Court."

The above illustration shows the basic principles on which reduction of Capital book-keeping entries are founded. Further details may now be introduced.

Illustration.—Rayon d'Or, Ltd., was registered with a nominal capital of £250,000, divided into 50,000 5 % Cumulative Preference Shares, 100,000 7 % Non-Cumulative Second Preference Shares, and 100,000 Ordinary Shares, all of £1 each. After several successful years, the company encountered three years of bad trade. On December 31, 19.., the Balance Sheet of the company was as shown on p. 422.

The 5 % First Preference shareholders declined to agree to any reduction of their shares on the ground that they held preferential rights both as to dividend (cumulative) and capital. The necessary meetings of the Second Preference and Ordinary shareholders were called, and a special resolution was passed on January 15, 19.., and embodied in an order of the Court dated March 10, 19.., as folows:—

> **Resolved** that the capital of Rayon d'Or, Ltd., be reduced as follows: The 80,000 7 % Non-Cumulative Preference Shares of £1 each to be reduced to 80,000 shares of 15s. each fully paid, and the 80,000 Ordinary Shares of £1 each to be reduced to 80,000 shares of 5s. each fully paid, and that such reductions shall be effected by writing off capital which has been lost or is no longer represented by available assets.

* The words "and Reduced" need only be added where the Court so directs.

By this scheme £80,000 was made available for writing off losses and depreciated assets, viz. :—

	£
Reduction of 7% Non-Cumulative Preference Shares	20,000
Reduction of Ordinary Shares	60,000
	£80,000

It was decided to utilise this sum as follows :—

	£
(*a*) To write off Patents Account	30,000
(*b*) To write off Debenture Issue Expenses Account	2,780
(*c*) To write off the debit balance of Profit and Loss Account	20,712
(*d*) To write £11,782 off the Stock	11,782
(*e*) To write £14,726 off Machinery and Plant	14,726
	£80,000

It was also decided to transfer the Reserve Account to the credit of Machinery and Plant Account in order further to reduce the book value of that asset.

The entries required for this scheme of reductions are as follows :—

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			Dr. £	s.	d.	Cr. £	s.	d.
19.. Mar. 10	7 % 2nd Preference Share Capital Account Dr.	3	20,000	0	0			
	To Reduction of Capital Account	27				20,000	0	0
	Being 5s. per share on 80,000 shares of £1 each written off as per order of the Court, dated this day.							
„ 10	Ordinary Share Capital Account .. .. .. Dr.	5	60,000	0	0			
	To Reduction of Capital Account	27				60,000	0	0
	Being 15s. per share on 80,000 shares of £1 each written off as per order of the Court, dated this day.							
„ 10	Reduction of Capital Account . .. .. Dr.	27	80,000	0	0			
	To Sundries :—							
	Patents Account	15				30,000	0	0
	Debenture Issue Expenses Account	23				2,780	0	0
	Profit and Loss Account	25				20,712	0	0
	Stock	19				11,782	0	0
	Machinery and Plant	17				14,726	0	0
	Being allocation of the amount available for the reduction of assets and losses under the above order.							
„ 10	Reserve Account .. .. Dr.	11	3,000	0	0			
	To Machinery and Plant Account	17				3,000	0	0
	Being transfer of the former account.							

LEDGER.

1 5 % Cumulative 1st Preference Share Capital Account. 1

Dr.			£	s.	d.				Cr. £	s.	d.
						19... Dec. 31	By Balance .. .	√	50,000	0	0

LEDGER—*continued.*

3 7 % NON-CUMULATIVE 2ND PREFERENCE SHARE CAPITAL ACCOUNT. 3

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Mar. 10	To Reduction of Capital Account	J 46	20,000	0	0	19.. Dec. 31	By Balance	√	80,000	0	0
,, 10	,, Balance carried down	√	60,000	0	0						
		£	80,000	0	0			£	80,000	0	0
						19... Mar. 10	By Balance brought down	√	60,000	0	0

5 ORDINARY SHARE CAPITAL ACCOUNT. 5

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Mar. 10	To Reduction of Capital Account	J. 46	60,000	0	0	19... Dec. 31	By Balance	√	80,000	0	0
,, 10	,, Balance carried down	√	20,000	0	0						
		£	80,000	0	0			£	80,000	0	0
						19 .. Mar. 10	By Balance brought down	√	20,000	0	0

7 SUNDRY CREDITORS. 7

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Sundries	√	32,869	0	0

9 BANK LOAN. 9

Dr. Cr

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance	√	11,762	0	0

11 RESERVE ACCOUNT. 11

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Mar. 10	To Machinery and Plant Account	J. 46	3,000	0	0	19... Dec. 31	By Balance	√	3,000	0	0
			£3,000	0	0				£3,000	0	0

13 LEASEHOLD FACTORY. 13

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance	√	100,896	0	0						

LEDGER—*continued.*

15 **PATENTS ACCOUNT** 15

DR. CR.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance .. .	√	30,000	0	0	19... Mar. 10	By Reduction of Capital Account	46	30,000	0	0
		£	30,000	0	0			£	30,000	0	0

17 **MACHINERY AND PLANT.** 17

DR. CR.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance	√	52,785	0	0	19... Mar. 10	By Reduction of Capital Account	46	14,726	0	0
						,, 10	,, Reserve Account	46	3,000	0	0
						,, 10	,, Balance carried down	√	35,059	0	0
		£	52,785	0	0			£	52,785	0	0
19... Mar. 10	To Balance brought down .. .	√	35,059	0	0						

19 **STOCK.** 19

DR. CR.

			£	s.	d			J.	£	s.	d.
19... Dec. 31	To Balance	√	38,898	0	0	19... Mar. 10	By Reduction of Capital Account	46	11,782	0	0
						,, 10	,, Balance carried down	√	27,116	0	0
		£	38,898	0	0			£	38,898	0	0
19... Mar. 10	To Balance brought down	√	27,116	0	0						

21 **SUNDRY DEBTORS.** 21

DR. CR.

			£	s.	d				£	s.	d.
19... Dec. 31	To Sundries	√	29,776	0	0						

23 **DEBENTURE ISSUE EXPENSES ACCOUNT.** 23

DR. CR.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance	√	2,780	0	0	19... Mar. 10	By Reduction of Capital Account	46	2,780	0	0
			£2,780	0	0				£2,780	0	0

LEDGER—*continued.*

25 **Profit and Loss Account.** 25

Dr.			£	s.	d.		Cr.		£	s.	d.
19... Dec. 31	To Balance	√	20,712	0	0	19... Mar. 10	By Reduction of Capital Account	46	20,712	0	0
		£	20,712	0	0			£	20,712	0	0

27 **Reduction of Capital Account.** 27

Dr		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Mar. 10	To Sundry Asset Accounts.. ..	46	80,000	0	0	19.. Mar. 10	By 2nd Preference Share Capital Account	46	20,000	0	0
						" 10	" Ordinary Share Capital Account	46	60,000	0	0
		£	80,000	0	0			£	80,000	0	0

29 **4½ % Debentures.** 29

Dr.			£	s.	d.		Cr.		£	s.	d.
						19... Dec. 31	By Balance	√	20,000	0	0

72 **CASH BOOK.** 72

Dr.			£	s.	d.		Cr.		£	s.	d.
19... Dec. 31	To Balance	√	1,784	0	0						

[Note—For Balance Sheet after reduction, *see* p. 428.]

The first Balance Sheet prepared after such a reduction sometimes discloses the details of the reduction by showing the original values and the amount by which they are reduced. There is, however, no legal necessity to give such details, but if the Balance Sheet is to be laid before a General Meeting, the basis of valuation of the fixed assets must be stated.

EXAMINATION QUESTION.

The Directors of Fitzgeralds, Ltd., decide to reduce the company's capital *of* 120,000 shares *of* £1 *each, fully paid, to* 120,000 *shares of* 10s. *each,* fully paid.

Prior to the proposed reduction of capital the Balance Sheet of the company was as follows :—

[*Continued on p.* 429.

BALANCE SHEET, MARCH 10, 19...
(AFTER REDUCTION OF CAPITAL.)

	£ s. d.	£	s.	d.		£	s.	d.
Capital :—					Leasehold Factory	100,896	0	0
Nominal—					Machinery and Plant	35,059	0	0
50,000 5 % Cumulative 1st Preference Shares of £1 each	50,000 0 0				Stock	27,116	0	0
100,000 7 % Non-Cumulative Preference Shares of 15s. each	75,000 0 0				Sundry Debtors	29,776	0	0
100,000 Ordinary Shares of 5s. each	25,000 0 0				Cash at Bank	1,784	0	0
	£150,000 0 0							
Issued—								
50,000 5 % Cumulative 1st Preference Shares of £1 each	50,000 0 0							
80,000 7 % Non-Cumulative 2nd Preference Shares of 15s. each ..	60,000 0 0							
80,000 Ordinary Shares of 5s. each	20,000 0 0							
		130,000	0	0				
Debentures: 200 4½ % Debentures of £100 each		20,000	0	0				
Sundry Creditors		32,869	0	0				
Bank Loan		11,762	0	0				
£		194,631	0	0	£	194,631	0	0

See note to Balance Sheet on p. 423.

BALANCE SHEET

	£	s.	d.		£	s.	d.
Share Capital	120,000	0	0	Goodwill	40,000	0	0
Bank Overdraft	10,000	0	0	Freehold Factory	81,000	0	0
Sundry Creditors	52,250	0	0	Machinery and Plant	12,500	0	0
Premium on Shares Account ..	2,000	0	0	Patents	8,500	0	0
				Stock	11,000	0	0
				Sundry Debtors	10,800	0	0
				Cash	200	0	0
				Profit and Loss Account	20,250	0	0
£	184,250	0	0	£	184,250	0	0

It was decided (1) to eliminate the Premium on Shares Account; (2) to write off the debit balance of the Profit and Loss Account; and (3) to re-value the assets as follows: Goodwill, £20,000; Patents, nil; Stock, £10,000; and any balance remaining available to be used to write down the book value of the Freehold Factory.

Submit the entries necessary in order to carry these decisions into effect and give the Balance Sheet of the company as it would appear after the reduction of capital had been effected. (*London Chamber Commerce.*)

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			Dr. £	s.	d.	Cr. £	s	d.
19... Dec. 31	Share Capital Account .. .. Dr.	1	60,000	0	0			
	To Reduction of Capital Account	3				60,000	0	0
	Being reduction of 120,000 shares of £1 each to 10s. each.							
„ 31	Premiums on Shares Account .. .. Dr.	2	2,000	0	0			
	To Reduction of Capital Account	3				2,000	0	0
	Balance of former account transferred.							
„ 31	Reduction of Capital Account .. .. Dr.		62,000	0	0			
	To Sundries :—							
	Profit and Loss Account					20,250	0	0
	Goodwill	5				20,000	0	0
	Patents					8,500	0	0
	Stock					1,000	0	0
	Freehold Factory					12,250	0	0
	Being allocation of the amount available for the reduction of assets and losses.							

LEDGER

1 SHARE CAPITAL ACCOUNT. **1**

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Reduction of Capital Account	12	60,000	0	0	19... Dec. 31	By Balance	√	120,000	0	0
„ 31	„ Balance carried down	√	60,000	0	0						
		£	120,000	0	0			£	120,000	0	0
						19... Dec. 31	By Balance brought down	√	60,000	0	0

LEDGER—*continued.*

3 REDUCTION OF CAPITAL ACCOUNT. 3

Dr.												Cr.
		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Sundry Assets..	12	62,000	0	0	19... Dec. 31	By Premium on Shares Account	12	2,000	0	0
						„ 31	„ Share Capital Account .. .	12	60,000	0	0
			£62,000	0	0				£62,000	0	0

5 GOODWILL. 5

Dr.											Cr.
			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance .. .	√	40,000	0	0	19... Dec. 31	By Reduction of Capital Account	12	20,000	0	0
						„ 31	„ Balance carried down	√	20,000	0	0
			£40,000	0	0				£40,000	0	0
19... Dec. 31	To Balance brought down	√	£20,000	0	0						

(The remaining Ledger accounts need not be reproduced here, as they are similar to the above.)

Return of Capital to Shareholders.—Owing to altered circumstances, companies occasionally find themselves possessed of a larger capital than they require. The redundant capital may have resulted because the company has curtailed its operations, e.g. abandoned its foreign trade, or be due to a particular piece of legislation. If such a condition should arise, Sections 55 and 56 authorise the return of that part of the capital no longer required, and the company may either, with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company (S. 55, 1 [*c*]). This power, however, can only be exercised provided the Articles originally, or as altered for the purpose by special resolution, sanction such a course, and by special resolution subsequently confirmed by the Court. Further, where the proposed reduction involves either diminution of liability in respect of unpaid share capital, or the repayment of any paid-up share capital, any creditor of the company may object to the reduction. The Court may then settle a list of the creditors, and if satisfied with respect to every creditor that either his consent to the reduction of capital has been obtained, or that his debt or claim has been discharged or has been secured, may make an order confirming the reduction on such terms and conditions as it thinks fit (SS. 56 and 57).

Illustration.—Blanks, Ltd., was registered with a capital of 100,000 shares of £1 each. Owing to the imposition of high tariffs by various foreign countries, their export department was closed down, and the original capital could no longer be employed profitably. It was therefore decided to reduce the 100,000 shares of £1 each to 100,000 shares of 15s. each, and to return 5s. per share to the shareholders. A special resolution was passed to give effect to this decision, no creditor of the company objected, and the Court confirmed the reduction of capital. The entries necessary are as follows :—

JOURNAL. 12

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Share Capital Account .. .. Dr.	2	25,000	0	0			
	To Sundry Shareholders	3				25,000	0	0
	Being 5s per share returnable to shareholders on 100,000 shares of £1 each, now reduced to 100,000 shares of 15s. each.							

1 CASH BOOK. 1

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec 31	By Cash. Sundry Shareholders, 5s. per share on 100,000 shares	3	25,000	0	0

LEDGER.

2 Share Capital Account. 2

Dr. Cr.

		J.	£	s.	d				£	s.	d.
19... Dec. 31	To Sundry Shareholders	12	25,000	0	0	19... Dec.31	By Balance	√	100,000	0	0
" 31	" Balance carried down	√	75,000	0	0						
		£	100,000	0	0			£	100,000	0	0
			5			19... Dec.31	By Balance brought down	√	75,000	0	0

3 Sundry Shareholders. 3

Dr. Cr.

		C.B.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Cash	1	25,000	0	0	19... Dec.31	By Share Capital Account	12	25,000	0	0

Suitable amendment of the Share Register is also necessary recording *the alteration in the denomination of the shares.*

EXAMINATION QUESTIONS.

1. A limited company issued £50,000 Ordinary Capital in £10 shares, payable £1 on application, £4 on allotment, and the balance two months later. The company also issued £50,000 in Debentures of £100 each, payable 10 % on application and the balance on allotment. The whole was subscribed and allotted on January 10, 19... Give the necessary Journal entries to record the above. (*National Union Teachers.*)

2. Make the Journal entries necessary in order to record the undermentioned transaction: The Southern Cross Packing Company, Ltd., issued, on June 30, 19.. 100,000 Ordinary £1 shares at a premium of 5s. per share, payable on application. The shares applied for were payable as to 10s. per share on application and as to 15s. per share upon allotment. The issue was fully subscribed by the public. Allotment duly took place for the whole issue on July 15, 19... (*London Chamber Commerce.*)

3. Laurent Carle, Ltd., a newly formed Company, issued 50,000 Ordinary Shares of £1 each and 50,000 6 % Preference Shares of £1 each. Of these, 51,650 Ordinary Shares were applied for, 50,000 of which were allotted; and 48,500 Preference Shares, all of which were allotted.

Briefly describe the procedure necessary in order to carry out the issue and allotment of these shares, and give rulings of any special books or papers you would recommend.

Both classes of shares were payable: 2s. 6d. per share on application, January 3, 19..; 5s. per share on allotment, January 5, 19..; 12s. 6d. per share, first and final call, January 31, 19... (*Royal Society Arts.*)

4. The Tulip Soap Company, Ltd., was formed on January 1, 19.., with a nominal capital of 60,000 shares of £1 each, divided into 15,000 5 % Preference Shares and 45,000 Ordinary Shares. 8,000 Preference Shares were allotted and paid for in full on January 10th. 35,000 Ordinary Shares were allotted on January 15th, 5s. being paid on application and allotment. A final call was made on March 5th, when all amounts were paid except the final call on 100 shares. On March 25th £7,000 was raised by the issue of 5 % Debentures, the cost of the same, £380, being paid in cash on that day. On April 15th the company purchased the business of G. Gale, taking over the following assets: Plant, £5,000; Stock, £3,000; Sundry Debtors, £2,000, which were paid for by the allotment of 2,000 Preference Shares and 3,000 Ordinary Shares, fully paid, and the balance in cash.

Show Cash and Ledger accounts and Journal entries to record the above transactions and the Balance Sheet of the Company as at April 30, 19... (*Central Association Accountants.*)

5. The West African Rubber Company, Ltd., which was registered with a capital of £100,000, divided into 1,000,000 shares of 2s. each, invited applications for its capital, payable 6d. per share on application, 1s. per share on allotment, and the remainder one month after allotment. On April 1, 19.., 1,200,000 shares were applied for, and the deposits thereon received. On April 6th following, applications for 800,000 shares were accepted in full, while applicants for the remaining 400,000 shares were allotted half the number they had respectively applied for. The balance due on allotment was in each case received on the following day, and the final instalment was received on May 6, 19... You are asked to show the record of the above transactions in the Company's Cash Book and Journal and in the following accounts in the Ledger: (*a*) Applications Account; (*b*) Allotment Account; (*c*) Call Account; (*d*) Share Capital Account. (*Chartered Institute Secretaries.*)

6. The Mosside Pumping Company, Ltd., was registered in 19.. with a Nominal Capital of 500,000 shares of £1 each. During the same year 250,000 of these shares were issued and fully paid up.

The balance of the Share Capital was offered to the public in 19.. at a premium of 5s. per share. Of these shares 200,000 were applied for and duly allotted, payable as to 7s. 6d. per share on application (including the premium) and 2s. 6d. per share one month after allotment. No further call was made during the year. The expenses of the second issue amounted to £1,025, of which amount £500 was written off during the year.

Show how the above transactions would appear in the Company's Balance Sheet as on December 31st last. (*Chartered Accountants.*)

7. Whiteheads, Ltd., issued new capital on February 28, 19.., consisting of 40,000 Ordinary Shares of £1 each, payable as to 5s. on application, 5s. on allotment, and 10s. one month after allotment. The shares were issued at a premium of 5s. per share, payable on allotment, and the issue was over-subscribed to the extent of 10,000 shares. Make the necessary Cash Book and Journal entries, the whole of the money having been duly received by the Company. (*Chartered Accountants.*)

8. Journalise the following transactions of a limited company:—

The company was registered on January 1, 19.., with a Nominal Capital of £120,000 divided into 120,000 shares of £1 each, of which 40,000 were issued as fully paid to the vendor as part purchase consideration, 40,000 offered for subscription to provide working capital, payable as to 5s. per share on application, 5s. per share on allotment, and the remainder in two calls of 5s. each; 40,000 shares to be held in reserve for future issue. The vendor also received £10,000 in 5 % Debentures, being the balance of the purchase consideration. (*Chartered Accountants.*)

9. A limited company, with a Nominal Capital of £50,000 in 50,000 Ordinary shares of £1 each, was formed to acquire an existing business. Shares to the value of £10,000 were issued to the vendors as fully paid, and 20,000 shares were subscribed for by the public. During the first year 15s. per share was called up, being 5s. per share on application, 5s. per share on allotment, 2s. 6d. per share first call, and 2s. 6d. per share second call. At the end of the first year there had been paid up on the shares subscribed for by the public: On 15,000 shares the full amount called; on 3,000 shares 12s. 6d. per share; on 1,500 shares 10s. per share; on 500 shares 5s. per share.

You are required to give the entries necessary to record the Capital transactions in the books of the company, taking into consideration the fact that all shares upon which less than 10s. per share had been paid were forfeited by resolution of the Directors. You are also required to show how the Capital would appear in the Balance Sheet of the company at the end of the first year. (*Chartered Institute Secretaries.*)

10. The Denton Mining Company, Ltd., was registered on January 1, 19.., with a Nominal Capital of £150,000, to acquire the Daluth Tin mining claim from Prospectors, Ltd. The purchase price of the claim was agreed at £50,000, payable as follows: Cash, £10,000; Ordinary Shares, £30,000; Debentures, £10,000.

The Company offered 100,000 Ordinary Shares of £1 each for public subscription on January 3, 19.., at a premium of 5s. per share, payable as to 7s. 6d. per share (including the premium of 5s.) on application, 5s. per share on allotment, and the balance on February 15th.

On January 10th the Directors went to allotment upon applications for 85,650 shares, all of which were allotted, and the allotment moneys duly paid on or before February 1, 19... The final call was also duly paid with the exception of the amount due upon a holding of 500 shares. The agreement with Prospectors, Ltd., was carried out on January 25th.

Give the necessary entries to record these transactions, and show how they would appear in the Company's Balance Sheet. (*Chartered Institute Secretaries.*)

11. The Oriental Supplies Company, Ltd., made an issue of 50,000 Ordinary Shares of £1 each at a premium of 2s. per share, 2s. 6d. per share payable on application, 4s. 6d. (including the premium) on allotment, and 5s. on first call, due three months after allotment, and the balance as required.

The Application List was closed on March 25, 19.., when it appeared that applications had been received for 60,000 shares.

On March 31st the Directors met and allotted shares as follows: Applicants for 40,000 shares in full; applicants for 15,000 shares, 10,000; applicants for 5,000 shares, nil, their application money being returned on April 1st.

The whole of the amounts due on application and allotment were received by April 10th.

The first call became due on June 30, 19.., and was all received by July 8th, with the exception of the call due on 1,000 shares.

The call on these 1,000 shares not having been received, the shares were duly declared forfeited by the Directors on September 30, 19...

Make the necessary entries in the Cash Book and Journal of the Company to record the above transactions. (*Chartered Accountants.*)

12. Can shares be issued at (*a*) a discount, (*b*) a premium? If so, how should the transactions be dealt with in the books of the company? (*Central Association Accountants.*)

13. The Redesdale Trading Company, Ltd., had a total subscribed Capita of £100,000 in Ordinary Shares of £10 each, on which £7 10s. had been called up. A final call was made, and all amounts were paid except £25 due from W. Ford, who owned 10 shares. These shares were forfeited and reissued at £9 per share for cash. Show the General Ledger Accounts in which the above transactions are recorded and the balances thereof as they would appear in the Balance Sheet of the Company. (*Central Association Accountants.*)

14. One thousand shares of £1 each in the Allmetal Aircraft Company, Ltd., were allotted to Henry Brown, of Middlesbrough, ironmaster, on March 1, 19...

He paid 5s. per share on application, and 5s. per share on allotment. A first call of 5s. per share was made, payable on June 1, 19... This he failed to pay, and the Directors of the Company decided to forfeit his shares. Notice of the intention to forfeit was given on August 1, 19.., and as the call still remained unpaid the shares were duly forfeited on September 1, 19... In the meantime a second call of 5s. per share had been made, payable on September 1, 19...

On October 1, 19.., the forfeited shares were reissued as fully paid to William Watts, of Corporation Street, Manchester, cotton merchant, at the price of 15s. per share.

Describe the usual course of procedure in forfeiting shares, and make the entries in the books of the company necessary to show the full effect of the above transaction. (*Chartered Accountants.*)

15. Sorrell & Son, Ltd., was registered as a limited liability company on October 1, 19.., with an Authorised Capital of £500,000. The company went to allotment on November 1, 19.., when 200,000 Ordinary Shares at £1 each were allotted at a premium of 2s. 6d. per share, payable 2s. 6d. on application, 5s. (including premium) on allotment, and the balance on May 1st next. All the allotment and call money was paid when due except in the case of one shareholder, who failed to pay the final call on 200 shares held by him. His shares were forfeited on June 1, 19... Show the necessary entries in the books of the company to record these transactions. (*Central Association Accountants.*)

16. The Directors of a limited company forfeited 1,000 Ordinary Shares of £1 each owing to non-payment of the final call of 10s. per share. The shares were subsequently reissued to another shareholder for a cash payment of 22s. 6d. per share.

(1) Are these proceedings *intra vires* ?

(2) What steps should you take to enable you to arrive at a decision ?

(3) How should the transactions be dealt with in the Balance Sheet which you are asked to certify ? (*Chartered Accountants.*)

17. On February 11, 19.., the Directors of a limited company resolved that 60 shares of £1 each, issued to Howard Jones, should be forfeited for non-payment of the amounts payable on allotment and first call, viz. 7s. 6d. and 5s. respectively ; the deposit on application, 2s. 6d., had been paid. No further call was made. On March 25, 19.., they resolved that the said shares be issued to Robert Elmsley on payment by him of £40. Make the necessary entries in the company's books, including the Share Ledger. (*Chartered Accountants.*)

18. Prepare "Statutory Report" from the following figures :—*Receipts :* On allotment of 50,000 shares of £10 each, £137,000. Proceeds sale of old building material removed from freehold, £1,742. Advanced on mortgage, £47,000. Received in respect of allotment of Debenture Stock (75 % of £100,000), £75,000. *Payments :* Purchase of freehold, £205,000. Paid builders on account, £12,600. Paid for Stock in Bond, £24,350. Paid salaries, £247. Office and petty expenses, £147. Preliminary expenses to date, £2,471. (*Chartered Accountants.*)

19. Submit the Balance Sheet of a Company showing a large balance standing to the debit of Profit and Loss Account. Suggest a scheme for reduction of capital, and submit the Balance Sheet of the Company as it would appear when your proposed scheme of reduction of capital had been carried out.

20. How should the discount on the issue of Debentures be dealt with in the undermentioned circumstances ? (*a*) Black, Ltd., issued 1,000 Debentures of £1,000 each at 95, repayable at par in ten years. (*b*) White, Ltd., issued £100,000 5 % Perpetual Debenture Stock at 95. In each case the expenses of the issue, apart from discount, amounted to £3,500. (*London Chamber Commerce.*)

21. On January 1st, Excelsa, Ltd., offered for subscription 500 4 % Debentures of £100 each, repayable in five years at par. The price of issue was 98, payable as to £10 per Debenture on application, and the balance on March 1st. Applications were received for 600 Debentures, and 500 were duly allotted on January 3rd. The underwriting and costs of the issue amounted to £500. Give the entries which these transactions would necessitate, and show how the issue would appear in the Balance Sheet of the Company as on December 31st. (*London Chamber Commerce.*)

22 Malmaison, Ltd., issued £100,000 5 % Debentures, in bonds of £100 each, on January 1, 19... The Debentures were issued at a premium of 5 %, and were payable as to 20 % on application, as to 30 % (including the premium of 5 %) on allotment (January 10th), and the balance on January 25th. Applications for 1,035 bonds were received.

Give the entries necessary to record the issue, and show how the above transactions would appear in the Balance Sheet of the Company. (*Chartered Institute Secretaries.*)

23. Describe the expenditure which, in your opinion, may be legitimately debited to "Preliminary Expenses Account" by a newly registered limited company.

State how you would deal with this expenditure in the books and published accounts of the company. (*London Chamber Commerce.*)

24. Describe the difference, if any, in the book-keeping records of a dividend paid (*a*) Free of Income Tax; (*b*) Less Income Tax. (*Royal Society Arts.*)

25. The Directors of a limited company, with a fully paid Capital of 100,000 Ordinary Shares of £1 each, decided to pay an interim dividend of 10 %, *less tax*, as on July 1st.

Give the entries necessary to record the payment of the dividend. (*London Chamber Commerce.*)

26. Explain the functions and advantages of a "Dividend Book" as employed by limited companies.

Submit a suitable ruling for a book of this nature, and make three specimen entries therein. (*Royal Society Arts.*)

27. The Directors of the Stanfram Company, Ltd. (Capital authorised, subscribed and paid up, £50,000), at the end of their first year's trading, decide to recommend the payment of a dividend of 5 %, and request you to advise as to the formalities incidental to the payment of the dividend. (*a*) State your recommendations; and (*b*) draft rulings for a *pro-forma* Dividend List. (*Incorporated Accountants.*)

28. A company is desirous of reducing its Capital. State shortly the steps that must be taken to effect its purpose where the Articles do not contain a clause empowering the company to make any such reduction. For what purpose is a reduction of Capital usually required? (*Incorporated Accountants.*)

29. Prepare the imaginary Balance Sheet of a company which has sustained considerable trading losses and depreciation of capital assets.

Assume that it has been decided to reduce the capital of the company by converting the fully paid £1 shares into shares of 10s. each, and redraft the Balance Sheet, showing the position after the reduction of capital has been duly carried out. (*Royal Society Arts.*)

30. In what cases and subject to what conditions is a company entitled to pay interest out of Capital? (*Chartered Institute Secretaries.*)

31. A successful Rubber Plantation Company found that its £5 shares rose to such a premium that the market became restricted. A special resolution was therefore duly passed dividing the Company's 10,000 Ordinary Shares of £5 each into 200,000 shares of 5s. each.

Show the entries which are necessary in order to give effect to the above resolution. (*Royal Society Arts.*)

32. The prospectus of Partington, Ltd., was publicly advertised on January 21st, with the following loan and share issues: *Debentures*: 1,000 4 % debentures of £100 each, the whole of which were offered and fully subscribed and paid up. *Preference Shares*: 20,000 6 % Preference Shares of £5 each, the whole of which were offered and fully subscribed and paid up. *Ordinary Shares*: Nominal, 30,000 Shares of £5 each, of which 10,000 shares were issued as fully paid to the vendors in part payment of the purchase price of the business. Of the remaining 20,000 shares the public subscribed for 15,000 shares, the whole of which were, in due course, fully paid up, with the exception of the last call of £2 per share on 500 shares, which were subsequently forfeited by resolution of the Directors. Pass the necessary entries through the Company's books to record these transactions, and state how they should appear in the Balance Sheet. (*London Chamber Commerce.*)

33. What are "preliminary expenses," and how are they dealt with by limited companies? To what extent (if any) are these expenses allowed by the Income Tax authorities as a charge against revenue? (*London Chamber Commerce.*)

34. The Annual Accounts of Ravary's, Ltd., showed a balance to the credit of Profit and Loss Account of £5,950, as on December 31, 19... The Nominal Capital of the Company consisted of 10,000 shares of £1 each, all of which had been subscribed and fully paid up.

At the annual meeting in February 19.. it was decided: (*a*) To increase the Nominal Capital of the Company to £15,000 by the issue of 5,000 6 % Preference Shares of £1 each. (*b*) To pay a dividend for the year 19.. of 55 %, 50 % to be discharged by the issue of fully paid Preference Shares at par, and the balance, 5 %, to be paid in cash.

Give the entries necessary to record these transactions. (*Royal Society Arts.*)

35. The accounts of Pain and Peters, Ltd., on December 31, 19.., showed a balance to the credit of Profit and Loss Account of £5,870. The Company was a private one, with a Nominal Capital of £15,000 in shares of £1 each, 10,000 of which were subscribed and fully paid up. These were held as follows: A, 4,000; B, 4,000; C, 1,000; D, 1,000. At the annual general meeting of the Company, at which all the shareholders were present, it was unanimously decided as follows:—

(1) To increase the Nominal Capital of the Company to £25,000, the additional £10,000 to consist of 10,000 6 % Cumulative Preference Shares of £1 each.

(2) To pay a dividend for 19.. of 50 %, of which 20 % was to be paid in cash and 30 % by the issue of Preference Shares at par, treated as fully paid.

Make the Journal entries necessary to give effect to the above resolutions. (*Chartered Accountants.*)

36. What do you understand by "Debentures issued at a discount"? How would you show such Debentures in the Balance Sheet of a company? Give an example. (*London Chamber Commerce.*)

37. The Directors of the Argonaut Company, Ltd., issue £250,000 4 % Debenture Stock at the price of 90. How should the discount be dealt with in the Company's Balance Sheets from year to year? (*Chartered Accountants.*)

38. A company issues £100,000 Debenture Stock at 90 %, and pays 2 % for underwriting it. How should the transactions show in the company's books? (*Chartered Accountants.*)

39. The Balance Sheet of the Lomax Company was composed of the following items: Paid-up Capital, £10,000; Debentures, £6,000; Cash, £11,000; Debtors, £4,000; Creditors, £3,000; Stock, £6,000; Premises, £5,000; Balance of Profit, £7,000. Instead of declaring a dividend, it was decided to exercise the option of paying off the whole of the debentures at a premium of 3 %. Give the entries in the various Ledger accounts affected, and draw up a Balance Sheet showing the new position. (*National Union Teachers.*)

40. Sudemeyer, Ltd., issued £100,000 5 % Debentures, in bonds of £100 each on January 1, 19... The Debentures were issued at a premium of 5 %, and were payable as to 20 % on application, as to 30 % (including the premium of 5 %) on allotment (January 10th), and the balance on January 25th. Applications for 1,035 bonds were received.

Give the entries necessary to record the issue, and show how the above transactions would appear in the Balance Sheet of the Company. (*Chartered Institute Secretaries.*)

41 A company made an issue of £100,000 Debenture Stock, secured by trust deed on all the fixed and floating assets of the company. Of this amount £50,000 was subscribed at a premium of 2 %, £30,000 was subscribed

at par, and £20,000 was issued to the company's bankers by way of collateral security for a loan of £15,000. Give the entries which should appear in the company's Balance Sheet to record these transactions. (*Chartered Accountants.*)

42. A company has a Capital of £100,000 in Ordinary Shares of £1 each (fully paid up) and a debit balance on Profit and Loss Account of £50,000. It is desired to reduce the shares to 10s. each, in order to wipe off the debit balance. State what steps must be taken to carry out the scheme, and, assuming that to have been done, show the entries that would have to be made in the books. (*Chartered Institute Secretaries.*)

43. A limited company with a fully paid capital consisting of 200,000 Ordinary Shares of £1 each has traded unsuccessfully, with the result that the debit balance of the Profit and Loss Account now amounts to £68,585. It is decided, subject to confirmation by the Court, to reconstruct the company, and to reduce the £1 shares to shares of 10s. each fully paid. The balance of the Capital written off, after dealing with the Profit and Loss Account, is to be utilised in reducing the book value of assets of a wasting nature. Submit a *pro forma* Balance Sheet on the basis of the Capital and Profit and Loss figures above, and submit the entire procedure necessary to carry out the proposed reduction of Capital. (*Chartered Accountants.*)

44. How is a reduction of a company's Capital ordinarily effected? State particularly what steps are necessary where it is proposed (*a*) to return capital to the shareholders; (*b*) to write off Capital which has been lost; (*c*) to cancel shares which have not been taken up. (*Central Association Accountants.*)

45. A limited company is formed to purchase an existing business with a nominal capital of £200,000, one-half in Ordinary and one-half in 5 % Preference Shares of £1 each. 60,000 of the Ordinary Shares are issued at a premium of 5s. per share, the Preference Shares being all issued at par; 5s. per share being payable on application and 10s. on allotment in each case. £20,000 6 % Debentures are underwritten at 98 %. On account of the purchase money of £54,000 a sum of £8,000 is paid in discharge of the liabilities of the vendor, and the following assets taken over: Stock-in-trade, £12,000; Book Debts, £20,000; Machinery and Plant, £6,000.

Journalise the entries necessary for recording the purchase in the books of the company. (*Incorporated Accountants.*)

CHAPTER XII

JOINT STOCK COMPANIES—*Continued*

COMPANY ACCOUNTANCY—*Continued.*

[NOTE.—The references are to the *Companies Act*, 1929, unless otherwise stated.]

Purchase of a Business.—When a company is formed for the purchase of the business of a going concern, the first duty of the book-keeper is to make himself acquainted with the terms of the contract with the vendors, or the promoting syndicate, as the case may be. The purchase price will usually consist of cash and fully paid shares in agreed proportions. The greater the proportion taken in shares, the greater will be the public confidence in the venture.

The assets taken over will usually include a named sum for goodwill, though sometimes a round sum is fixed for the whole undertaking, including goodwill. In the latter case the amount payable for goodwill is represented by the excess of the purchase price over the value of the net assets acquired (i.e., over the tangible assets acquired, minus the liabilities assumed).

The last Balance Sheet of the Vendor's business (with or without adjustments) usually forms the basis of the purchase contract. When the purchasing company assumes the liabilities, the vendor usually guarantees that they shall not exceed the Balance Sheet figures; frequently also he guarantees the book debts. In such cases, the book-keeper must make any adjustments that may prove necessary, the vendor's account being debited or credited as occasion requires.

Procedure to Record Purchase of a Business.

(*a*) Open a Purchase Account and debit it with the agreed purchase price of the business and credit the vendor with the like amount.

(*b*) Open an account for each asset acquired (including Goodwill) and debit the respective book values to these accounts. Credit Purchase Account with the like amounts in one total.

(*c*) Open accounts for the liabilities assumed and credit these accounts with their respective balances, as shown in the Balance Sheet. Debit Purchase Account with the like amounts in one total.

(*d*) If the vendor takes shares in part payment of the purchase price, credit Share Capital Account (or Debenture Account, if debentures are issued), in part payment, with the issued value of the shares (or debentures), and debit the vendor with a like amount.

(*e*) The entries recording the balance (if any) of the shares or debentures issued will be similar to those already fully described (*see* p. 346).

(*f*) Debit the Cash Book with the balance taken over, and any receipts on Share and Debenture Account, and credit all payments made to the vendor, or in payment of expenses.

Illustration 1.—Testouts, Ltd., was registered with a nominal capital of £200,000, divided into 100,000 Ordinary Shares of £1 each, and 100,000 7 % Preference Shares of £1 each. A contract was entered into with Hugh Dickson agreeing to purchase his established business for the sum of £125,000. The purchase price was to be satisfied by the issue of 30,000 fully paid ordinary shares of £1 each, taken as representing 25s. per share; 50,000 fully paid 7 % Preference Shares of £1 each; and the balance in cash. The company was to pay the liabilities which the vendor guaranteed should not exceed the Balance Sheet figure. The vendor also guaranteed that the book debts should not realise less than £18,980. 25,000 Ordinary Shares at 25s. per share and 25,000 7 % Preference Shares of £1 each were issued to the public, and fully paid up as on February 1, 19... The Balance Sheet of Hugh Dickson, as on the date of purchase, was as follows:—

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Capital (H. Dickson)	100,000	0	0	Freehold Premises..	48,762	0	0
Sundry Creditors	12,413	0	0	Machinery and Plant	37,412	0	0
Bills Payable	12,000	0	0	Furniture and Fittings ..	897	0	0
				Sundry Debtors	18,980	0	0
				Stock	15,600	0	0
				Cash at Bank	2,762	0	0
£	124,413	0	0	£	124,413	0	0

The book debts realised £18,400, and a further liability (omitted from the Balance Sheet) amounting to £150 was paid. The preliminary expenses of the new company amounted to £3,850.

11 CASH BOOK. 11

Dr. Cr.

19..		J.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Purchase Account	12	2,762	0	0	Dec. 31	By Preliminary Expenses	31	3,850	0	0
,, 31	,, Sundry Shareholders:—					,, 31	,, Sundry Creditors	13	12,413	0	0
	25,000 Ordinary Shares at 25s...	28	31,250	0	0	,, 31	,, Bills Payable ..	15	12,000	0	0
	25,000 7 % Preference Shares at £1 each	30	25,000	0	0	,, 31	,, Vendor, Balance due to him ..		36,770	0	0
,, 31	,, Cash (Sundry Debtors)	8	18,400	0	0	,, 31	,, Sundry Creditors (omitted from Balance Sheet)..	13	150	0	0
						,, 31	,, Balance carried down	√	12,229	0	0
		£	77,412	0	0			£	77,412	0	0
19... Dec. 31	To Balance brought down	√	12,229	0	0						

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundry Assets :— Dr.							
	Freehold Premises	1	48,762	0	0			
	Machinery and Plant	3	37,412	0	0			
	Furniture and Fittings	5	897	0	0			
	Sundry Debtors	7	18,980	0	0			
	Stock	9	15,600	0	0			
	Cash	C.B. 11	2,762	0	0			
	To Purchase of Business Account	17				124,413	0	0
	Being the assets taken over by the Company as per contract dated December 18, 19...							
,, 31	Purchase of Business Account Dr.	17	24,413	0	0			
	To Sundries :—							
	Sundry Creditors	13				12,413	0	0
	Bills Payable	15				12,000	0	0
	Being liabilities assumed by the Company as per contract dated December 18, 19...							
,, 31	Purchase of Business Account Dr.	17	125,000	0	0			
	To Vendor	19				125,000	0	0
	Being agreed purchase price of the business as per contract dated December 18, 19...							
,, 31	Vendor Dr.	19	87,500	0	0			
	To Sundries :—							
	Ordinary Share Capital Account	21				30,000	0	0
	Ordinary Shares Premiums Account	23				7,500	0	0
	7 % Preference Capital Account	25				50,000	0	0
	Being allotment of 30,000 Ordinary Shares at 25s. per share, and 50,000 7 % Preference Shares of £1 each, both fully paid as per contract for sale.							
Feb. 12	Vendor Dr.	19	730	0	0			
	To Sundry Debtors	7				580	0	0
	,, Sundry Creditors	13				150	0	0
	Being amounts necessary to make up amounts guaranteed as per contract for sale							
,, 12	Ordinary Shareholders Dr.	27	31,250	0	0			
	To Ordinary Share Capital Account	21				25,000	0	0
	,, Ordinary Share Premiums Account	23				6,250	0	0
	For application, allotment, and call moneys on 25,000 Ordinary Shares issued at 25s. per share.							
,, 12	7 % Preference Shareholders Dr.	29	25,000	0	0			
	To 7 % Preference Share Capital Account	25				25,000	0	0
	For application, allotment, and call moneys on 25,000 7 % Preference Shares of £1 each.							
,, 12	Goodwill Account Dr.	33	25,000	0	0			
	To Purchase of Business Account	17				25,000	0	0
	Being transfer of balance representing Goodwill.							

LEDGER.

1 FREEHOLD PREMISES. 1

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Purchase Account	12	48,762	0	0						

LEDGER—*continued.*

19 Vendor's Account. 19

Dr.											Cr.
19...		J.	£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Ordinary and Preference Share Capital Accounts ..	12	87,500	0	0	Dec. 31	By Purchase of Business Account	12	125,000	0	0
" 31	" Adjustment of Sundry Debtors and Creditors	12	730	0	0						
" 31	" Cash	C.B. 12	36,770	0	0						
		£	125,000	0	0			£	125,000	0	0

21 Ordinary Share Capital Account. 21

Dr.											Cr.
			£	s.	d.	19...		J.	£	s.	d.
						Dec. 31	By Vendor	12	30,000	0	0
						" 31	" Sundry Shareholders	12	25,000	0	0
								£	55,000	0	0

23 Ordinary Share Premiums Account. 23

Dr.											Cr.
			£	s.	d	19...		J.	£	s.	d.
						Dec. 31	By Vendor	12	7,500	0	0
						" 31	" Sundry Shareholders	12	6,250	0	0
								£	13,750	0	0

25 7 % Preference Share Capital Account. 25

Dr.											Cr.
			£	s.	d.	19...		J.	£	s.	d.
						Dec. 31	By Vendor	12	50,000	0	0
						" 31	" Sundry Shareholders	12	25,000	0	0
								£	75,000	0	0

27 Ordinary Shareholders. 27

Dr.											Cr.
19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Dec. 31	To Ordinary Share Capital and Premiums Accounts	12	31,250	0	0	Dec. 31	By Cash	11	31,250	0	0

29 7 % Preference Shareholders. 29

Dr.											Cr.
19...		J.	£	s.	d.	19 ..		C.B.	£	s.	d.
Dec. 31	To 7 % Preference Share Capital Account	12	25,000	0	0	Dec. 31	By Cash	11	25,000	0	0

LEDGER—*continued.*

31 PRELIMINARY EXPENSES ACCOUNT. 31

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Cash	C.B. 12	3,850	0	0						

33 GOODWILL ACCOUNT. 33

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Purchase of Business Account ..	J. 12	25,000	0	0						

Testouts, Limited.

BALANCE SHEET, JANUARY 1, 19...

	£	s.	d.		£	s.	d.
Capital :— *Nominal :—* 100,000 Ordinary Shares of £1 each .. £100,000; 100,000 7 % Preference Shares of £1 each 100,000; £200,000				Freehold Premises	48,762	0	0
				Goodwill	25,000	0	0
				Machinery and Plant	37,412	0	0
				Furniture and Fittings . ..	897	0	0
				Stock	15,600	0	0
				Cash at Bank	12,229	0	0
				Preliminary Expenses Account..	3,850	0	0
Issued :— 55,000 Ordinary Shares of £1 each .. .. £55,000; 75,000 7 % Preference Shares of £1 each 75,000	130,000	0	0				
Ordinary Shares Premiums Account	13,750	0	0				
£	143,750	0	0	£	143,750	0	0

NOTE—As this Balance Sheet is not to be laid before a General Meeting, the basis of valuation of fixed assets, etc., need not be stated.

Illustration 2.—Chatenays, Ltd., was registered with a nominal capital of £200,000, consisting of 200,000 Ordinary Shares of £1 each. A contract was entered into with G. Dickson to purchase his established business as on December 31, 19.., for the sum of £60,000, to be satisfied by the issue as fully paid of 25,000 Ordinary Shares taken at 25s. per share and the balance in cash.

In addition to the shares issued as fully paid as above, 60,000 shares were offered on January 5th to the public for subscription at 25s. per share, payable as follows : On application, 5s. ; on allotment, 10s. (including the premium of 5s.) ; and on first and final call (March 5th), 10s. per share. The whole issue was underwritten for a commission of 2½ %, and an overriding commission of 1 %, and a brokerage of 3d. per share was offered to stockbrokers and others for placing shares. The public applied for 65,000 shares. The Directors went to allotment on January 10th, on which day Allotment Letters and Letters of Regret were posted.

Duty, legal charges, and other preliminary expenses amounted to £4,750. All moneys due on the shares were paid on or before March 7th, except the final call of 10s. per share on 500 shares which remained unpaid. 3,200 shares were allotted on application forms bearing the stamp of stockbrokers.

On March 3rd, fifty 5 % Debentures of £100 each were issued at 98½,

and were fully subscribed and paid up. The expenses of the issue amounted to £426.

You are required to prepare the following :—

(1) Opening Journal entries ;
(2) Cash Book ;
(3) Ledger Accounts ;
(4) Trial Balance ; and
(5) Balance Sheet of the new Company.

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Jan. 1	Sundry Assets (net) .. .. Dr.	25	60,000	0	0			
	To G. Dickson	27				60,000	0	0
	Being purchase price of the Assets acquired as per Contract for Sale.							
" 1	G Dickson .. .. Dr.	27	60,000	0	0			
	To Ordinary Share Capital Account	1				25,000	0	0
	" Ordinary Share Premiums Account	3				6,250	0	0
	" Cash	C.B. 5				28,750	0	0
	Being 25,000 Ordinary Shares (taken at 25s.) and Cash in discharge of purchase consideration as per Contract for Sale.							
" 10	Application and Allotment Account .. .. Dr.	5	45,000	0	0			
	To Ordinary Share Capital Account	1				30,000	0	0
	" Ordinary Share Premiums Account	3				15,000	0	0
	Being amounts payable on 60,000 shares allotted by Directors to the public this day.							
Mar. 3	Sundry Debenture Holders .. .. Dr.	15	4,925	0	0			
	Debenture Discount Account .. .. .. Dr.	13	75	0	0			
	To 5 % Debentures	11				5,000	0	0
	Being amount due and discount on 50 £100 Debentures issued this day at 98½.							
" 5	First and Final Call Account .. .. .. Dr.	7	30,000	0	0			
	To Ordinary Share Capital Account	1				30,000	0	0
	Being Call due this day on 60,000 shares.							
" 7	Calls in Arrear .. .. Dr.	9	250	0	0			
	To First and Final Call Account	7				250	0	0
	Being Call of 10s. per share on 500 shares unpaid.							

LEDGER.

1 Ordinary Share Capital Account. 1

Dr. / Cr.

			£	s.	d.			J.	£	s.	d.
						19... Jan. 1	By G. Dickson ..	9	25,000	0	0
						" 10	" Application and Allotment ..	9	30,000	0	0
						Mar. 5	" First and Final Call	9	30,000	0	0
									£85,000	0	0

3 Ordinary Share Premiums Account. 3

Dr. / Cr.

			£	s.	d.			J.	£	s.	d.
						19... Jan. 1	By G. Dickson ..	9	6,250	0	0
						" 10	" Application and Allotment ..	9	15,000	0	0
									£21,250	0	0

LEDGER—*continued.*

5 **Application and Allotment Account.** 5

Dr.		J.	£	s.	d.		Cr.	C.B.	£	s.	d.
19 .. Jan. 10	To Ordinary Share Capital Account	9	30,000	0	0	19 .. Jan. 5	By Cash	5	45,000	0	0
,, 10	,, Ordinary Share Premiums Account .. .	9	15,000	0	0						
		£	45,000	0	0			£	45,000	0	0

7 **First and Final Call Account.** 7

Dr.		J.	£	s.	d		Cr.	C.B.	£	s.	d.
19... Mar. 5	To Ordinary Share Capital Account	9	30,000	0	0	19... Mar. 5	By Cash	5	29,750	0	0
						,, 7	,, Calls in Arrear	J. 9	250	0	0
		£	30,000	0	0			£	30,000	0	0

9 **Calls in Arrear.** 9

Dr.		J.	£	s.	d.		Cr.		£	s.	d.
19... Mar. 7	To First and Final Call Account	9	250	0	0						

11 **5 % Debentures Account.** 11

Dr.			£	s.	d.		Cr.	J.	£	s.	d.
						19... Mar. 3	By Sundry Debenture Holders ..	9	4,925	0	0
						,, 3	,, Debenture Discount	9	75	0	0
									£5,000	0	0

13 **Debenture Discount Account.** 13

Dr.		J.	£	s.	d		Cr.		£	s.	d.
19... Mar. 3	To 5 % Debentures Account	9	75	0	0						

15 **Sundry Debenture Holders.** 15

Dr.		J.	£	s.	d		Cr.	C.B.	£	s.	d.
19... Mar. 3	To 5 % Debentures	9	4,925	0	0	19... Mar. 3	By Cash	5	4,925	0	0

17 **Underwriting Commission, etc.** 17

Dr.		C.B.	£	s.	d.		Cr.		£	s.	d.
19... Jan. 1	To Cash	5	2,100	0	0						

LEDGER—*continued*.

19 PRELIMINARY AND FORMATION EXPENSES. 19

DR. CR.

			£	s.	d.				£	s.	d.
19... Jan 1	To Cash	C.B. 5	4,750	0	0						

21 DEBENTURE ISSUE EXPENSES ACCOUNT. 21

DR. CR.

			£	s.	d.				£	s.	d.
19... Mar. 7	To Cash	C.B. 5	426	0	0						

23 BROKERAGE. 23

DR CR.

			£	s.	d.				£	s.	d.
19... Jan. 1	To Cash	C.B. 5	40	0	0						

25 SUNDRY ASSETS. 25

DR. CR.

			£	s.	d.				£	s.	d.
19... Jan. 1	To G. Dickson ..	J. 9	60,000	0	0						

27 G. DICKSON, VENDOR. 27

DR. CR.

			£	s.	d.				£	s.	d.
19... Jan. 1	To Ordinary Shares	J. 9	31,250	0	0	19... Jan. 1	By Sundry Assets	J. 9	60,000	0	0
" 1	" Cash	C.B. 5	28,750	0	0						
		£	60,000	0	0			£	60,000	0	0

TRIAL BALANCE, MARCH 7, 19...

		DR. £	s.	d.	CR. £	s.	d.
Ordinary Share Capital Account	1				85,000	0	0
Ordinary Share Premiums Account	3				21,250	0	0
Calls in Arrear	9	250	0	0			
5 % Debentures Account	11				5,000	0	0
5 % Debenture Discount Account	13	75	0	0			
Underwriting Commission	17	2,100	0	0			
Preliminary and Formation Expenses	19	4,750	0	0			
Debenture Issue Expenses Account	21	426	0	0			
Brokerage	23	40	0	0			
Sundry Assets	25	60,000	0	0			
Cash in hand..	C.B. 5	43,609	0	0			
	£	111,250	0	0	£111,250	0	0

CASH BOOK.

5 Dr. | | | | | | | | | | | | | Cr. 5

Date	Particulars	Fo.	£	s.	d.	Date	Particulars	Fo.	£	s.	d.
19... Jan. 25	To Sundry Shareholders (Application and Allotment)	5	45,000	0	0	19... Jan. 1	By G. Dickson (Balance of Purchase Price)	27	28,750	0	0
Mar. 3	" Sundry Debenture Holders	15	4,925	0	0	" 1	" Underwriting Commission	17	2,100	0	0
" 5	" Sundry Shareholders (First and Final Call)	7	29,750	0	0	" 1	" Brokerage	23	40	0	0
						" 1	" Preliminary and Formation Expenses	19	4,750	0	0
						Mar. 7	" Debenture Issue Expenses	21	426	0	0
						" 7	" Balance carried down	√	43,609	0	0
			£79,675	0	0				£79,675	0	0
19... Mar. 7	To Balance brought down	√	43,609	0	0						

Chatenays, Limited.

BALANCE SHEET, MARCH 7, 19...

Liabilities		£	s.	d.	Assets	£	s.	d.
Capital:—					Sundry Assets	60,000	0	0
Nominal: 200,000 Ordinary Shares of £1 each	£200,000 0 0				Preliminary and Formation Expenses (including Brokerage)	4,790	0	0
Issued: 85,000 Ordinary Shares of £1 each	85,000 0 0				Underwriting Commission	2,100	0	0
Less Calls in Arrear	250 0 0				Debenture Issue Expenses Account	426	0	0
		84,750	0	0	Debenture Discount Account	75	0	0
Ordinary Share Premiums Account		21,250	0	0	Cash at Bank	43,609	0	0
5 % Debentures		5,000	0	0				
	£	111,000	0	0	£	111,000	0	0

Note.—This Balance Sheet would not be laid before a General Meeting, and details of assets, etc., are therefore not compulsory.

EXAMINATION QUESTION.

A limited company was formed to purchase the business of Victor Hugo, whose Balance Sheet as at the date of purchase was as follows :—

BALANCE SHEET.

	£	s.	d.		£	s.	d.
Capital	15,000	0	0	Leasehold Factory	10,500	0	0
Sundry Creditors	4,200	0	0	Machinery and Plant	5,240	0	0
Loan from Bank ..	4,000	0	0	Sundry Debtors ..	3,260	0	0
Bills Payable ..	600	0	0	Stock	3,100	0	0
				Cash at Bank ..	420	0	0
				Bills Receivable ..	1,280	0	0
£	23,800	0	0	£	23,800	0	0

The purchase terms were as follows :—

(1) The purchase price was agreed at £17,500, payable as to £10,000 in cash and as to £7,500 in fully paid shares.
(2) Victor Hugo was to retain the Cash at Bank and Bills Receivable, and undertook to meet the Bills Payable.
(3) The company took over all the remaining assets at their book values and undertook to discharge the liabilities other than Bills Payable.
(4) The capital of the company, subscribed by the public, was £30,000 in Ordinary Shares of £1 each, of which 15s. was called up and fully paid.
(5) The Preliminary Expenses amounted to £586.

Give the entries necessary to open the books of the company upon the completion of the purchase, and submit the initial Balance Sheet. (*London Chamber Commerce.*)

Solution.

CASH BOOK.

3 Dr. | Cr. 3

			£	s.	d.				£	s.	d.
19... Dec. 31	To Sundry Shareholders (on Application, Allotment, and Call Account) ..	9	22,500	0	0	19... Dec. 31	By Vendors	5	10,000	0	0
						" 31	" Sundry Creditors	13	4,200	0	0
						" 31	" Bank Loan ..	15	4,000	0	0
						" 31	" Preliminary Expenses	17	586	0	0
						" 31	" Balance carried down	√	3,714	0	0
		£	22,500	0	0			£	22,500	0	0
19... Dec. 31	To Balance brought down	√	3,714	0	0						

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Purchase of Business Account .. .. Dr.	1	17,500	0	0			
	To Vendors	5				17,500	0	0
	Being agreed purchase price of the business							
" 31	Sundry Assets .. .. Dr.							
	Leasehold Factory	19	10,500	0	0			
	Machinery and Plant	21	5,240	0	0			
	Sundry Debtors	23	3,260	0	0			
	Stock	25	3,100	0	0			
	To Purchase of Business Account	1				22,100	0	0
	Being book values of assets taken over.							
" 31	Purchase of Business Account .. .. .. Dr.	1	8,200	0	0			
	To Sundry Creditors	13				4,200	0	0
	,, Bank Loan	15				4,000	0	0
	Being liabilities taken over from Vendor.							
,, 31	Vendors .. .. Dr.	5	7,500	0	0			
	To Share Capital Account	7				7,500	0	0
	Being 7,500 shares of £1 each issued as fully paid in part satisfaction of the purchase price.							
,, 31	Application, Allotment, and Call Account .. Dr.	9	22,500	0	0			
	To Share Capital Account	7				22,500	0	0
	Being transfer of the former account to Share Capital Account.							

LEDGER.

1 **Purchase of Business Account.** 1

Dr. Cr.

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Vendors .	12	17,500	0	0	Dec. 31	By Sundry Assets	12	22,100	0	0
,, 31	,, Sundry Creditors		4,200	0	0	,, 31	,, Transfer to Goodwill Account ..	27	3,600	0	0
,, 31	,, Bank Loan ..		4,000	0	0						
		£	25,700	0	0			£	25,700	0	0

5 **Vendors.** 5

Dr. Cr.

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Share Capital Account ..	12	7,500	0	0	Dec. 31	By Purchase of Business Account	12	17,500	0	0
,, 31	,, Cash	C.B. 3	10,000	0	0						
		£	17,500	0	0			£	17,500	0	0

LEDGER—*continued.*

7 **SHARE CAPITAL ACCOUNT.** 7

DR. CR.

			£	s.	d.			J.	£	s.	d.
						19... Dec. 31	By Vendors. Fully paid shares ..	12	7,500	0	0
						" 31	" Application, Allotment, and Call Account	12	22,500	0	0
								£	30,000	0	0

9 **APPLICATION, ALLOTMENT, AND CALL ACCOUNT.** 9

DR. CR.

		J.	£	s.	d.			C.B.	£	s.	d.
19... Dec. 31	To Share Capital Account ..	12	22,500	0	0	19... Dec. 31	By Cash, Sundry Shareholders ..	3	22,500	0	0

13 **SUNDRY CREDITORS.** 13

DR. CR.

		C.B.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Cash	3	4,200	0	0	19... Dec. 31	By Purchase of Business Account ..	12	4,200	0	0

15 **BANK LOAN.** 15

DR. CR.

		C.B.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Cash	3	4,000	0	0	19... Dec. 31	By Purchase of Business Account ..	12	4,000	0	0

17 **PRELIMINARY EXPENSES ACCOUNT.** 17

DR. CR.

		C.B.	£	s.	d.				£	s.	d.
19... Dec. 31	To Cash	3	586	0	0						

19 **LEASEHOLD FACTORY.** 19

DR. CR.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Purchase of Business Account	12	10,500	0	0						

LEDGER—*continued.*

21 MACHINERY AND PLANT. 21

Dr.		J.	£	s.	d.			Cr.	£	s.	d.
19... Dec. 31	To Purchase of Business Account	12	5,240	0	0						

23 SUNDRY DEBTORS. 23

Dr.		J.	£	s.	d.			Cr.	£	s.	d.
19... Dec. 31	To Purchase of Business Account	12	3,260	0	0						

25 STOCK. 25

Dr.		J.	£	s.	d.			Cr.	£	s.	d.
19... Dec. 31	To Purchase of Business Account	12	3,100	0	0						

27 GOODWILL. 27

Dr.		J.	£	s.	d.			Cr.	£	s.	d.
19... Dec. 31	To Purchase of Business Account	1	3,600	0	0						

New Company.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Goodwill	3,600	0	0
Issued:—					Leasehold Factory	10,500	0	0
7,500 shares of £1 each issued as fully paid to vendor..	£7,500				Machinery and Plant	5,240	0	0
30,000 shares of £1 each issued to public, 15s. per share called up..	22,500				Stock	3,100	0	0
		30,000	0	0	Sundry Debtors	3,260	0	0
					Cash at Bank	3,714	0	0
					Preliminary Expenses Account ..	586	0	0
	£	30,000	0	0	£	30,000	0	0

NOTE.—This Balance Sheet, if laid before a General Meeting, must state the basis of valuation of the fixed assets.

Reconstruction.—Reconstruction is not a term of any legal significance. It expresses re-organisation, and this may take many forms. Reconstruction of a company may become necessary by reason of financial losses, but frequently reconstruction is entered upon for quite different reasons. Thus a company may be re-organised for any one of the following purposes :—

(*a*) Amalgamation with one or more similar undertakings.
(*b*) Absorption of a smaller company.
(*c*) To enlarge the "objects" detailed in the Memorandum.
(*d*) In order to write off lost capital.
(*e*) To provide means to satisfy the claims of creditors, or the claims of cumulative preference shareholders for arrears of dividend, otherwise than by payment in cash.
(*f*) Consolidation of existing share issues, or re-arrangement of the rights of various classes of shareholders *inter se*.
(*g*) Alteration of the denomination of the Shares, e.g. the issue of ten £1 shares for every share of £10 held.
(*h*) To alter the domicile of the company.
(*i*) To reduce or extinguish the uncalled liability on the issued shares.

In earlier days, under the Act of 1862, reconstruction involved liquidation and the formation of a new company. The Act of 1908 provided ample legal machinery for reconstruction in many of the above events without liquidation, and the Act of 1929 contains similar machinery.

We have already seen that, under S. 50, a company may, if authorised by its Articles, increase, consolidate and sub-divide its capital ; convert its paid-up shares into stock ; and cancel unissued shares.

We have also seen that, under S. 55, if authorised by the Articles, a company may, by special resolution subsequently confirmed by the Court, extinguish or reduce the liability on share capital not paid up ; cancel share capital which is lost or unrepresented by assets ; pay off paid-up share capital in excess of its wants.

Under S. 46 a company may utilise undivided profits to pay off Redeemable Preference Shares (see p. 301).

Further, by S. 153, a company may compromise with its creditors, or its shareholders, or any class of them. On application to the Court for power so to do, the Court may order a meeting of the creditors, or of the shareholders, to be summoned to consider the proposal, and if the compromise or arrangement is sanctioned by a majority in number representing three-fourths in value of the creditors, or class of creditors, or shareholders or class of shareholders, present and voting either in person or by proxy, such compromise or arrangement may be sanctioned by the Court, and, if so, becomes binding upon the creditors or the shareholders concerned. This procedure is frequently made use of

in reconstruction proceedings in cases where a proportion of the outside liabilities of the company are satisfied by the issue of shares, or the arrears of cumulative preference dividends are similarly satisfied, or the denomination and rights of the various classes of shares are to be re-arranged.

Very briefly stated, the steps necessary to carry out a scheme of reconstruction, otherwise than by procedure under S. 153, are as follows :—

(*a*) If reduction of capital is involved the Articles must give authority, or must be amended by special resolution to give authority, and the company must pass a special resolution reducing the capital.

(*b*) If the proposed reduction is for the purpose of cancelling shares not issued, any resolution specified by the Articles will suffice.

(*c*) If it is simply a repayment of Redeemable Preference Shares out of accumulated profits, the procedure is under S. 46.

(*d*) If the reduction is for any other purpose than in (*b*) or (*c*) above, the Court must be petitioned to sanction the scheme. If the Court approves, an order is made which must be filed with the Registrar and published as the Court may direct. The Court's order takes effect only after registration (S. 58).

One of the most common reasons for reconstruction is the need to provide further working capital. It is necessary, sometimes, in this connection, to form a new company, and to proceed under the powers conferred by S. 234. The new company takes over the assets of the old company, and allots shares with an uncalled liability in the new company, in consideration for the assets taken over, thus providing further working capital. By S. 55, *Finance Act*, 1927, transfer and share capital duties are remitted to the extent of the share capital of the transferor company, subject to certain conditions (see p. 479).

In practice, reconstruction schemes are sometimes very difficult and complicated. More particularly, for example, in cases where two or more issues of debentures exist, secured upon different specific assets, followed by one or more issues of preference shares, with or without accumulated arrears of dividend, and with differing rights as to priority, and an issue of ordinary shares without preferential rights as to dividend or capital. The apportionment of the capital loss to be written off as between these different interests clearly needs nice adjustment. Having ascertained the capital loss to be provided for, and determined its incidence, it then becomes necessary in most cases to provide further working capital. Unless all these needs are satisfactorily provided for, the reconstruction scheme will come to naught.

In other cases, for instance (*c*), (*f*), (*g*), and (*h*) mentioned on p. 453, reconstructions impose very little work on the company book-keeper, for they entail no alteration in the books, except such amendments as may be necessary in the Share Register. The only new accounts

involved will be a new Preliminary Expenses Account, and any new Share Capital Account to record the fresh issue of capital, if a fresh issue is made. To the former account all the expenses of reconstruction would be debited, the balance being written off over a reasonable period in the manner explained in connection with Debenture Issue and similar expenses.

The following three illustrations give the basic principles on which reconstruction book-keeping is based. They are purposely presented in simple form, in order that these principles should not be obscured by complicated detail.

Illustration 1.—Blanks, Ltd., decided to sell their undertaking to a new company registered as Blanks (19..), Ltd. The purchase price was fixed at £50,000, payable by the issue of 100,000 shares in the new company, credited with 10s. per share as paid. The new company was to pay the liabilities of the old company. Goodwill Account was to be written off; Machinery and Plant Account reduced to £20,000; and the balance of the Profit and Loss Account was to be written off. The Balance Sheet of the old company at the date of the proposed reduction was as follows:—

Blanks, Limited.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Issued Capital: 100,000 shares of £1 each, fully paid ..	100,000	0	0	Goodwill	20,000	0	0
Sundry Creditors	40,200	0	0	Machinery and Plant	30,000	0	0
				Sundry Assets	69,800	0	0
				Cash	400	0	0
				Profit and Loss Account ..	20,000	0	0
£	140,200	0	0	£	140,200	0	0

Assuming that the sale to the new company was duly effected, and that the balance of 10s. per share had been called and paid up, the following records would appear:—

REALISATION ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Sundry Assets, etc., transferred to the new company	140,200	0	0	19... Dec. 31	By Purchase Price from the new company	50,000	0	0
					" 31	" Loss on Assets transferred to the new company ..	50,000	0	0
					" 31	" Sundry Creditors to be paid by the new company ..	40,200	0	0
	£	140,200	0	0		£	140,200	0	0

A Purchase of Business Account would be written up, as already explained on p. 439, to record the opening of the New Company

The Balance Sheet of Blanks (19..), Ltd., would appear as follows :—

Blanks (19..), Limited.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Issued Capital: 100,000 shares of £1 each, 10s. per share credited, and 10s. per share called and paid up	100,000	0	0	Machinery and Plant	20,000	0	0
				Sundry Assets	69,800	0	0
				Cash	10,200	0	0
£	100,000	0	0	£	100,000	0	0

NOTE.—This Balance Sheet is not prepared for laying before a General Meeting.

The above simple illustration serves to demonstrate the principles upon which the book-keeping entries are based. Further detail may now be introduced.

Illustration 2.—Uprichards, Ltd., after a series of trade losses, resolved by special resolution to wind up, and to reconstruct by means of a sale to a new company to be called Uprichards (19..), Ltd. At the date of the confirmatory resolution the Balance Sheet of the old company was as follows :—

Uprichards, Limited.

BALANCE SHEET, DECEMBER 31, 19..

		£	s.	d.		£	s.	d.
Capital :—					Freehold Factory	78,500	0	0
200,000 Ordinary Shares of £1 each, fully paid		200,000	0	0	Machinery and Plant	47,800	0	0
Sundry Creditors	£6,000				Motor Lorries	3,880	0	0
Bank Loan	3,000				Stock	18,282	0	0
Bills Payable	2,000				Sundry Debtors	21,820	0	0
		11,000	0	0	Cash at Bank	718	0	0
					Profit and Loss Account (accumulated loss)	40,000	0	0
	£	211,000	0	0	£	211,000	0	0

The parties concerned consented to the following reconstruction scheme :—

(*a*) The new company was to take over the assets of the old company, but not the liabilities.

(*b*) The capital of the new company was to consist of 500,000 Ordinary Shares of £1 each.

(*c*) The new company was to purchase the assets of the old company for £160,000, payable as to £140,000 by the issue of 280,000 Ordinary Shares of £1 each, credited with 10s. per share as paid up, and £20,000 in cash.

(*d*) The balance of 10s. per share payable by the members of the new company was to be paid as to 5s. on application and 5s. on allotment.

All moneys due on the new shares were paid. The expenses of reconstruction amounted to £9,000, and the preliminary and registration expenses of the new company to £5,000.

The following entries are necessary to record the reconstruction :—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Realisation Account .. .. Dr.	23	171,000	0	0			
	To Sundries :—							
	Freehold Factory	9				78,500	0	0
	Machinery and Plant	11				47,800	0	0
	Motor Lorries	13				3,880	0	0
	Stock	15				18,282	0	0
	Sundry Debtors	17				21,820	0	0
	Cash at Bank					718	0	0
	Being the transfer of these assets to the new company as per terms of the scheme dated this day.							
" 31	Uprichards (19..), Ltd. .. .. Dr.	25	160,000	0	0			
	To Realisation Account	23				160,000	0	0
	Being agreed purchase price of the assets of the old company.							
" 31	Shares in Uprichards (19..), Ltd. (the new company) .. .. Dr.	27	140,000	0	0			
	To Uprichards (19..), Ltd.	25				140,000	0	0
	Being the issue of 280,000 shares (10s. paid) as part purchase price of the assets as per scheme dated this day.							
" 31	Realisation Account .. .. Dr.	23	9,000	0				
	To Sundry Creditors	3				9,000	0	0
	Being cost of reconstruction scheme.							
" 31	Cash .. .. Dr.	19	20,000	0	0			
	To Uprichards (19..), Ltd.	25				20,000	0	0
	Being the cash portion of the purchase price as per scheme dated this day.							
" 31	Sundries :— Dr.							
	Sundry Creditors	3	15,000	0	0			
	Bank Loan	5	3,000	0	0			
	Bills Payable	7	2,000	0	0			
	To Cash	19				20,000	0	0
	For cash paid in discharge of the old company's liabilities, and costs of reconstruction scheme.							
	(NOTE.—In practice this entry would be omitted.)							
" 31	Share Capital Account (old company) .. Dr.	1	60,000	0	0			
	To Sundries :—							
	Profit and Loss Account	21				40,000	0	0
	Realisation Account	23				20,000	0	0
	Being balance at the debit of the old company's Profit and Loss Account, and loss on the transfer of the business to the new company in accordance with the scheme dated this day.							

On distribution of the shares to the shareholders of Uprichards, Ltd., the following Journal entry would close the books of the old company :—

			Dr. £	s.	d.	Cr. £	s.	d.
	Share Capital Account .. .. Dr.		140,000	0	0			
	To Shares in Uprichards (19..), Ltd.					140,000	0	0

LEDGER.

1 SHARE CAPITAL ACCOUNT. 1

Dr. | Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Profit and Loss Account (debit balance transferred)	26	40,000	0	0	19... Dec. 31	By Balance	√	200,000	0	0
" 31	" Realisation Account (loss on realisation) ..	26	20,000	0	0						
" 31	" Balance carried down	√	140,000	0	0						
		£	200,000	0	0			£	200,000	0	0
						19... Dec. 31	By Balance brought down	√	140,000	0	0

3 SUNDRY CREDITORS. 3

Dr. | Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Cash	26	15,000	0	0	19... Dec. 31	By Balance	√	6,000	0	0
						" 31	" Costs of Realisation	J. 26	9,000	0	0
			£15,000	0	0				£15,000	0	0

5 BANK LOAN. 5

Dr. | Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Cash	26	3,000	0	0	19... Dec. 31	By Balance	√	3,000	0	0
			£3,000	0	0				£3,000	0	0

7 BILLS PAYABLE. 7

Dr. | Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Cash	26	2,000	0	0	19... Dec. 31	By Balance	√	2,000	0	0
			£2,000	0	0				£2,000	0	0

9 FREEHOLD FACTORY. 9

Dr. | Cr.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance ..	√	78,500	0	0	19... Dec. 31	By Realisation Account	26	78,500	0	0
			£78,500	0	0				£78,500	0	0

LEDGER—*continued.*

11 MACHINERY AND PLANT. 11

DR. CR.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance ..	√	47,800	0	0	19... Dec. 31	By Realisation Account	26	47,800	0	0
			£47,800	0	0				£47,800	0	0

13 MOTOR LORRIES. 13

DR. CR.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance ..	√	3,880	0	0	19... Dec. 31	By Realisation Account	26	3,880	0	0
			£3,880	0	0				£3,880	0	0

15 STOCK. 15

DR. CR.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance ..	√	18,282	0	0	19... Dec. 31	By Realisation Account	26	18,282	0	0
			£18,282	0	0				£18,282	0	0

17 SUNDRY DEBTORS. 17

DR. CR.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance ..	√	21,820	0	0	19... Dec. 31	By Realisation Account ..	26	21,820	0	0
			£21,820	0	0				£21,820	0	0

19 CASH AT BANK. 19

DR. CR.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance ..	√	718	0	0	19... Dec. 31	By Realisation Account	26	718	0	0
,, 31	,, Cash, Uprichards (19..), Ltd., balance of purchase price	J. 26	20,000	0	0	,, 31	,, Sundry Creditors	26	20,000	0	0
			£20,718	0	0				£20,718	0	0

21 PROFIT AND LOSS ACCOUNT. 21

DR. CR.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance ..	√	40,000	0	0	19... Dec. 31	By Share Capital Account	26	40,000	0	0
			£40,000	0	0				£40,000	0	0

LEDGER—*continued.*

23 REALISATION ACCOUNT. **23**

DR. CR.

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Sundry Assets	26	171,000	0	0	19... Dec. 31	By Uprichards (19..) Ltd. (purchase price)	26	160,000	0	0
" 31	" Sundry Creditors (expenses of realisation)	26	9,000	0	0	" 31	" Share Capital Account	26	20,000	0	0
		£	180,000	0	0			£	180,000	0	0

25 UPRICHARDS (19..), LIMITED. **25**

DR. CR.

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Agreed Purchase Price of old Company	26	160,000	0	0	19... Dec. 31	By Shares issued to old company as part purchase price	26	140,000	0	0
						" 31	" Cash	26	20,000	0	0
		£	160,000	0	0			£	160,000	0	0

27 SHARES IN NEW COMPANY. **27**

DR. CR.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To 280,000 Shares (10s. paid) in Uprichards (19..), Ltd. ..	26	140,000	0	0						

The initial Balance Sheet of the new company, Uprichards (19..), Ltd., would appear as follows :—

Uprichards (19..), Limited.

BALANCE SHEET, JANUARY 1, 19...

	£	s.	d.		£	s.	d.
Capital :— *Nominal* 500,000 Ordinary Shares of £1 each £500,000				Sundry Assets taken over from the old company and written down to new valuations (set out details)	160,000	0	0
				Preliminary Expenses	5,000	0	0
Issued: 280,000 Ordinary Shares of £1 each (issued with 10s. paid), fully paid ..	280,000	0	0	Cash at Bank	115,000	0	0
£	280,000	0	0	£	280,000	0	0

A reconstruction embracing rather different characteristics, and treated, in some respects, on somewhat different lines, may now be given.

Illustration 3.—Blanks, Ltd., was registered with a capital of £100,000, divided into 30,000 6 % Cumulative Preference Shares of £1 each and 70,000 Ordinary Shares of £1 each. Both classes of shares were fully subscribed and paid up. The company had also issued 120 5 % Debentures of £100 each.

On December 31, 19.., the Balance Sheet of the company was as follows :—

Blanks, Limited.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Issued Capital :—					Goodwill	20,000	0	0
30,000 6 % Preference					Leasehold Property	34,762	0	0
Shares of £1 each..	£30,000				Patents	10,600	0	0
70,000 Ordinary Shares					Machinery and Plant	24,864	0	0
of £1 each	70,000				Stock	14,753	0	0
		100,000	0	0	Sundry Debtors	6,587	0	0
5 % Debentures		12,000	0	0	Cash at Bank	234	0	0
" " Interest Accrued		600	0	0	Profit and Loss Account (Balance)	12,800	0	0
Sundry Creditors		12,000	0	0				
	£	124,600	0	0	£	124,600	0	0

NOTE.—Two years' Dividend on the Preference Shares is in arrear.

The company's creditors were pressing, the debenture interest was twelve months in arrear, the dividend for the two years on the preference shares was in arrear, and working capital was urgently needed.

Meetings of the debenture holders, the two classes of shareholders and the creditors were held, and the following scheme was agreed to by all parties and sanctioned by the Court :—

(*a*) A new company was to be registered as Blanks (19..), Ltd., with a capital of 250,000 Ordinary Shares of 5s. each.

The purchase price of the old company's business was to be satisfied by the issue of a sufficient number of fully paid shares of the new company to meet the various agreements set out in the following paragraphs :—

(*b*) Two ordinary shares of 5s. each were to be issued as fully paid to the holder of each Preference Share of £1 in the old company.

(*c*) The arrears of preference dividend were to be satisfied by the issue of two fully paid shares of 5s. each in the new company for every £1 due.

(*d*) The debenture holders were to accept fully paid shares of 5s. each in the new company in satisfaction of the accrued interest.

(*e*) The creditors were to receive 15s. in the £ on their debts, to be satisfied by a cash payment of 10s. in the £ and the balance of 5s. by the issue of fully paid shares in the new company.

(*f*) One fully paid share of 5s. in the new company was to be issued for every ordinary share of £1 in the old company.

The balance of the capital of the new company was fully subscribed and paid up by several of the largest shareholders in the old company.

The amount rendered available by the reconstruction scheme was to be utilised as follows :—

The Patents, Goodwill, and the debit balance of the Profit and Loss Account were to be written off ; Machinery and Plant was to be reduced by £10,000 ; Stock by £9,000 ; and Leasehold Property by the balance available.

You are required to prepare :—

(1) A Statement showing the shares to be allotted as fully paid by the new company.

(2) The Journal entries recording the fulfilment of the reconstruction scheme.

(3) The Cash Book.

(4) The following Ledger accounts : Realisation Account and New Share Capital Account. (No other Ledger accounts are required.)

(5) The initial Balance Sheet of the reconstructed company.

It is assumed that debentures in the new company were issued in exchange for debentures in the old company, and that the Sundry Debtors and Balance of Cash were taken over by the new company, and that the creditors were paid off by the old company.

OLD COMPANY'S BOOKS.

JOURNAL.

	Dr. £	s.	d.	Cr. £	s.	d.
Realisation Account .. .. Dr.	81,200	0	0			
To Sundry Assets, viz. :—						
Leasehold Property				34,762	0	0
Machinery and Plant				24,864	0	0
Sundry Debtors				6,587	0	0
Stock				14,753	0	0
Cash				234	0	0
Being sundry assets taken over by Blanks (19..), Ltd., under reconstruction scheme.						
5 % Debentures Account .. .. Dr.	12,000	0	0			
To Realisation Account				12,000	0	0
Being Debentures taken over by Blanks (19..), Ltd., under reconstruction scheme.						
Blanks (19..), Ltd... .. .. Dr.	43,900	0	0			
To Realisation Account				43,900	0	0
Being agreed consideration under reconstruction scheme.						
Sundry Creditors .. .. Dr.	3,000	0	0			
To Reconstruction Account				3,000	0	0
Being amount written off Sundry Creditors under reconstruction scheme.						
Preference Share Capital Account .. .. Dr.	15,000	0	0			
Ordinary Share Capital Account .. .. .. Dr.	52,500	0	0			
To Reconstruction Account				67,500	0	0
Being amounts surrendered under reconstruction scheme.						
Reconstruction Account .. .. Dr.	1,800	0	0			
To Preference Shareholders' Account				1,800	0	0
Being arrears of Preference Dividend, at 10s. in the £, under reconstruction scheme.						
Reconstruction Account .. .. Dr.	25,300	0	0			
To Realisation Account				25,300	0	0
Being difference between consideration and net assets taken over under reconstruction scheme.						
Reconstruction Account .. .. Dr.	43,400	0	0			
To Goodwill				20,000	0	0
,, Patents				10,600	0	0
,, Profit and Loss Account				12,800	0	0
Being sundry debit balances written off under reconstruction scheme.						
Cash .. .. Dr.	6,000	0	0			
Ordinary Shares in Blanks (19..), Ltd. .. Dr.	37,900	0	0			
To Blanks (19..), Ltd.				43,900	0	0
Being satisfaction of consideration.						
Sundries Dr.						
Preference Share Capital Account	15,000	0	0			
Preference Shareholders' Account	1,800	0	0			
Ordinary Share Capital Account	17,500	0	0			
Debenture Interest Account	600	0	0			
Sundry Creditors	9,000	0	0			
To Ordinary Shares in Blanks (19..), Ltd. ..				37,900	0	0
,, Cash				6,000	0	0
Being distribution of consideration in accordance with the scheme.						

NEW COMPANY'S BOOKS.

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
Sundries Dr.							
To Sundries :—							
Leasehold Property		28,462	0	0			
Machinery and Plant		14,864	0	0			
Stock		5,753	0	0			
Sundry Debtors		6,587	0	0			
Cash		234	0	0			
5 % Debentures					12,000	0	0
Blanks, Ltd.					43,900	0	0
Being sundry assets and debentures taken over, and consideration therefor.							
Blanks, Ltd. Dr.		37,900	0	0			
To Ordinary Share Capital Account					37,900	0	0
Being 151,600 Ordinary Shares of 5s. each allotted as fully paid as per resolution of Directors, dated .... in part consideration.							
Cash Dr.		24,600	0	0			
To Ordinary Share Capital Account					24,600	0	0
Being cash payment in full for 98,400 Ordinary Shares of 5s. each, allotted as per resolution of Directors dated							
Blanks, Ltd. Dr.		6,000	0	0			
To Cash					6,000	0	0
Being balance of consideration.							

OLD COMPANY'S BOOKS.

CASH BOOK.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Balance	234	0	0	By Realisation Account	234	0	0
„ Blanks (19..), Ltd.	6,000	0	0	„ Sundry Creditors	6,000	0	0
	£6,234	0	0		£6,234	0	0

REALISATION ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Sundry Assets, transferred	81,200	0	0	By 5 % Debentures	12,000	0	0
				„ Blanks (19..), Ltd., consideration	43,900	0	0
				„ Reconstruction Account	25,300	0	0
£	81,200	0	0	£	81,200	0	0

RECONSTRUCTION ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Preference Shareholders' Account *re* dividend	1,800	0	0	By Share Capital Accounts, amounts written off	67,500	0	0
„ Realisation Account	25,300	0	0	„ Sundry Creditors	3,000	0	0
„ Sundry Assets, etc., written off	43,400	0	0				
£	70,500	0	0	£	70,500	0	0

NEW COMPANY'S BOOKS.

CASH BOOK.

Dr.		£	s.	d.	Cr.		£	s.	d.
	To Blanks, Ltd... ..	234	0	0		By Blanks, Ltd.	6,000	0	0
	„ Ordinary Shares Capital Account ..	24,600	0	0		„ Balance carried down	18,834	0	0
	£	24,834	0	0		£	24,834	0	0
	To Balance brought down	18,834	0	0					

Blanks (19..), Limited.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Capital:—				Leasehold Property	28,462	0	0
Nominal and Issued: 250,000				Machinery and Plant	14,864	0	0
Ordinary Shares of 5s. each,				Stock	5,753	0	0
fully paid	62,500	0	0	Sundry Debtors	6,587	0	0
5 % Debentures	12,000	0	0	Cash	18,834	0	0
£	74,500	0	0	£	74,500	0	0

Note.—This Balance Sheet is not intended to be laid before a General Meeting.

Amalgamation.—Combines for the purpose of amalgamating the assets, liabilities, and interests of two or more businesses engaged in the same trade are a growing feature of modern commerce. The procedure of amalgamation usually involves (*a*) the liquidation of all the combining companies, and the formation of a new company to purchase the combined undertakings, or (*b*) an increase of the capital of one member of the combine, and the issue of new shares to the other members, in satisfaction of the agreed purchase price of their businesses.

Holding (Parent) Companies.—Sometimes these combines take the form of Holding or Parent Companies formed to acquire the whole, or a controlling majority of the shares in other companies, called *Subsidiary Companies*. Frequently also the parent company conducts a trading business on its own account. The object of such companies is to control the operations of the subsidiaries, and to effect economy and harmony in their working. It is a simple and economical method of effecting a working amalgamation of companies engaged in similar trades.

At present such companies have no specific legal recognition, otherwise than as separate companies controlled by the regulations of the Companies Act. Common in the United States, they have within recent years attained some prominence in this country, and have provoked professional discussion which, to an extent, has been reflected in questions set to students at their examinations. Each subsidiary company is a separate legal entity with its own organisation, books of account, and board of Directors. But the parent company usually

reserves the right to nominate its representatives to sit on the subsidiary boards.

S. 155 contains provisions for facilitating the acquisition of the shares of a minority where a holding company is acquiring shares in another company (see p. 478).

By S. 127 a company is a subsidiary company if its shares, or more than fifty per cent. thereof, or more than fifty per cent. of the voting power or power to appoint the majority of the directors, is held directly or through a nominee by the parent company. It is not a subsidiary company for the purposes of the Act if the control is simply in the power to appoint directors and such power is merely derived from the provisions of a debenture trust deed or by virtue of shares issued to it for the purpose in pursuance of those provisions; nor if the "parent" company is a moneylending one holding shares merely as security.

By S. 126 the holding company must annex to its Balance Sheet a statement signed by the persons required to sign the Balance Sheet showing how the profits and losses of subsidiary companies (in aggregate) have been dealt with in or for the purposes of the accounts of the holding company, and to what extent provision has been made for losses of the subsidiary companies. The statement must contain particulars of the manner in which the reports of auditors of subsidiary companies have been qualified, where such is the case.

Holding Companies offer a wide and a somewhat complicated target for argument, but the one problem that concerns us here is the manner in which the Balance Sheet of the parent company should be presented. If the company's operations are confined to the investment of its funds in the shares of the subsidiaries, then practically the only asset appearing in the Balance Sheet will be "Shares in Subsidiary Companies." But if the company is also a trading company, there will be, in addition, the usual assets of a trading company.

The accounting questions arising in this connection are: (*a*) What information, if any, is to be afforded to the holding company's shareholders regarding the position of the subsidiaries? And (*b*) upon what basis is the valuation of the shares held in those companies to be made?

(*a*) *Information.*—The aggregate amount of shares in subsidiary companies, and the aggregate amount of indebtedness from subsidiary companies and the aggregate amount of indebtedness to subsidiary companies must be separately stated in the holding company's Balance Sheet (S. 125). The student will realize that in unscrupulous hands, the bald statement of the particulars required by S. 125 might conceal the fact that such shares and loans were of little or no value. The difficult question to decide is: What form the parent Balance Sheet should take, and what information it should contain? Some of the subsidiary companies may be public companies filing an Annual Balance Sheet with the Registrar; others may be, and fre-

quently are, private companies furnishing no such information. In many cases, therefore, the holding company's shareholders have no other information than that afforded by the accounts of the parent company, which, legally, may be confined to the bare item, " Investments in Subsidiary Companies." This meagre information could be enlarged by (*a*) Publishing with the parent Balance Sheet the Balance Sheets of the subsidiaries. In some cases this would be impracticable owing to the large number of the subsidiaries. Moreover, in most cases, possession of the subsidiary Balance Sheets would not furnish the desired facts without much additional information. (*b*) Publishing an analysed summary of the subsidiary accounts which provides details of the tangible assets, reserves, goodwill, and liabilities of the subsidiaries. (*c*) Publishing a consolidated Balance Sheet of the holding and subsidiary companies, in which all the assets and liabilities are grouped under suitable headings. This last method is practically universal in America, and furnishes a synopsis of the financial position of the group of companies as a whole from the point of view of the holding company. This treatment is analogous to that employed in the combined Balance Sheet of a Head Office and its branches. Contras can be eliminated, and the relation of the parent company's capital to the subsidiary companies' assets and liabilities is disclosed (see pp. 468–469).

(*b*) *Basis of Valuation.*—The fact most easy to ascertain is the first cost of the shares in the subsidiaries, and, in the majority of cases, this is the figure that appears in the holding company's Balance Sheet. Other, and somewhat academic, bases of valuation have been suggested, but, in normal circumstances, that is the most suitable basis of valuation, subject, of course, to such provisions and reserves as the facts may dictate. It would appear that a holding company is under no legal necessity to write down its investments, even in the face of known permanent depreciation (*Verner* v. *The General and Commercial Investment Trust, Ltd.*, [1894]). The shares are not held by the holding company for sale, but as an income-producing investment. Notwithstanding, adjustment in the cost value of the shares held should be made if such is rendered desirable by the circumstances, e.g. in the event of a permanent fall in the value of the assets held by the subsidiaries, or where a series of trading losses have been suffered.

EXAMINATION QUESTION

Major Co., Ltd., hold two-thirds of the issued capital of Minor Co., Ltd.

The Directors of Major Co., Ltd., ask you to draft a consolidated Balance Sheet of the whole undertaking, amalgamating the assets and liabilities of the subsidiary company, Minor Co., Ltd., with those of the Major Co., Ltd. (your detailed workings should be shown in an inner column).

The following are the Balance Sheets of the two companies as on 30th June, 19.. —

Major Co., Ltd.

	£	s.	d.	£	s.	d.		£	s	d.	£	s.	d.
Share Capital—							Goodwill				75,000	0	0
Authorised, issued and paid-up 500,000							Land and Buildings				150,000	0	0
Ordinary Shares of £1 each				500,000	0	0	Plant and Machinery				90,000	0	0
Sundry Creditors				275,000	0	0	Stocks				50,000	0	0
General Reserve				100,000	0	0	Sundry Debtors—						
Profit and Loss Account—							Advance to Minor Co., Ltd.	125,000	0	0			
Balance brought forward	15,000	0	0				Trade Debtors	105,000	0	0			
Add profit for year	85,000	0	0								230,000	0	0
Int. Div. from Minor Co., Ltd.	80,000	0	0				Bills Receivable—						
				180,000	0	0	Accepted by Minor Co., Ltd.				30,000	0	0
Note.—There are contingent liabilities in respect of—							Investments at cost—						
(a) Guarantee of principal of and interest on £50,000 6 % 1st Mortgage Debentures of Minor Co., Ltd.							War Loan	40,000	0	0			
							Minor Co, Ltd., 200,000 Ordinary Shares of £1 each	275,000	0	0			
											315,000	0	0
(b) Bills discounted £20,000							Balance at Bankers and Cash in hand				115,000	0	0
				£1,055,000	0	0					£1,055,000	0	0

Minor Co., Ltd.

	£	s.	d.	£	s.	d		£	s.	d.	£	s.	d.
Share Capital—							Goodwill				30,000	0	0
Authorised, issued and paid-up 300,000							Land and Buildings				175,000	0	0
Ordinary shares of £1 each				300,000	0	0	Plant and Machinery				225,000	0	0
6 % 1st Mortgage Debentures				50,000	0	0	Stocks				100,000	0	0
Bills payable issued to Major Co., Ltd.				50,000	0	0	Sundry Debtors				90,000	0	0
Sundry Creditors				200,000	0	0	Balance at Bankers and Cash in Hand				50,000	0	0
General Reserve				15,000	0	0							
Profit and Loss Account—													
Profit for year	175,000	0	0										
Deduct Interim Dividend paid, 40 %	120,000	0	0										
				55,000	0	0							
				£670,000	0	0					£670,000	0	0

The General Reserve of the Minor Co. was £10,000 when the Major Co. purchased the 200,000 shares, and £5,000 has been dded out of subsequent profits (*Chartered Accountants*).

olution.)

DRAFT CONSOLIDATED BALANCE SHEET OF MAJOR CO., LTD., AND ITS SUBSIDIARY COMPANY, MINOR CO., LTD., AS AT 30TH JUNE, 19..

LIABILITIES.

	£	s.	d.	£	s.	d.
are Capital—						
Authorised, issued and paid-up 500,000 Ordinary Shares of £1 each				500,000	0	0
ubsidiary Company, Capital held by outside shareholders and debenture holders—						
100,000 Ordinary Shares of £1 each fully paid	100,000	0	0			
6 % 1st Mortgage Debentures (secured on assets of book value of £640,000)	50,000	0	0			
				150,000	0	0
roportion of Reserves and Profit and Loss Balances of Subsidiary Company due to outside Shareholders—						
General Reserve (see below)	1,666	13	4			
Capital Reserve (see below)	3,333	6	8			
Profit and Loss (see below)	18,333	6	8			
				23,333	6	8
apital Reserve—						
Representing proportion of Reserve of Subsidiary Company at date of purchase, viz.	10,000	0	0			
Less: Proportion applicable to Outside Shareholders one-third	3,333	6	8			
Deducted per contra	£6,666	13	4			
ndry Creditors—						
Major Co , Ltd.	275,000	0	0			
Subsidiary Company £200,000 0 0						
Less : To Major Co., Ltd. .. 125,000 0 0	75,000	0	0			
				350,000	0	0

ASSETS.

	£	s.	d.	£	s.	d.	£	s.	d.
Goodwill—									
Major Co., Ltd.				75,000	0	0			
Subsidiary Company ..	30,000	0	0						
Add : Excess of Cost of Shares over their nominal value, viz ·									
Cost £275,000 0 0									
Nominal .. 200,000 0 0									
75,000 0 0									
Deduct— Capital Reserve per contra.. 6,666 13 4	68,333	6	8						
				98,333	6	8			
							173,333	6	8
Land and Buildings—									
Major Co., Ltd.				150,000	0	0			
Subsidiary Company				175,000	0	0			
							325,000	0	0
Plant and Machinery—									
Major Co , Ltd.				90,000	0	0			
Subsidiary Company				225,000	0	0			
							315,000	0	0
Stocks—									
Major Co., Ltd.				50,000	0	0			
Subsidiary Company				100,000	0	0			
							150,000	0	0

ills Payable—			
Subsidiary Company		50,000 0 0	
Less: Held by Major Co., Ltd.		30,000 0 0	
			20,000 0 0
eneral Reserves—			
Major Co., Ltd.		100,000 0 0	
Subsidiary Company	£15,000 0 0		
Less: Balance of Reserve when interest in Company was purchased transferred to Capital Reserve	10,000 0 0		
	5,000 0 0		
Less: Proportion applicable to outside Shareholders, one-third	1,666 13 4		
		3,333 6 8	
			103,333 6 8
rofit and Loss Account—			
Major Co., Ltd.—			
Balance brought forward		15,000 0 0	
Profit for year		85,000 0 0	
Interim Dividend from Subsidiary Company		80,000 0 0	
		180,000 0 0	
Subsidiary Company—			
Profit for year	175,000 0 0		
Less: Interim Dividend 40 %	120,000 0 0		
	55,000 0 0		
Less: Proportion applicable to outside shareholders, one-third	18,333 6 8		
		36,666 13 4	
			216,666 13 4
			£1,363,333 6 8

Sundry Debtors—		
Major Co., Ltd.	230,000 0 0	
Less: From Subsidiary Company	125,000 0 0	
	105,000 0 0	
Subsidiary Company	90,000 0 0	
		195,000 0 0
Bills Receivable, Major Co., Ltd.	30,000 0 0	
Less: From Subsidiary Company	30,000 0 0	
Investments—		
Major Co., Ltd.—		
War Loan		40,000 0 0
Balance at Bankers and Cash in hand—		
Major Co., Ltd.	115,000 0 0	
Subsidiary Company	50,000 0 0	
		165,000 0 0
		£1,363,333 6 8

NOTE.—Since this is not a "legal" Balance Sheet, bases of valuation, etc., need not be shown, although it is always preferable › do so. The question does not furnish the necessary details, however.

Amalgamation (*contd.*).—The holding companies referred to are practically investing companies. We will now return to amalgamations proper.

Illustration.—Inchiquins, Ltd., and Uprichards, Ltd., agreed to amalgamate. A new company, Soleil d'Or, Ltd., was registered to take over the combined undertaking as on January 1, 19... After negotiation, the assets and liabilities of the two companies were revalued, and agreed as set out in the following revised Balance Sheets.

Inchiquins, Limited.

BALANCE SHEET, DECEMBER 31, 19..

	£	s.	d.		£	s.	d.
Issued Capital:—				Freehold Factory	96,842	0	0
150,000 Ordinary Shares of £1				Machinery and Plant	24,485	0	0
each, fully paid	150,000	0	0	Motor Lorries	4,271	0	0
Sundry Creditors	17,815	0	0	Stock	21,325	0	0
Reserve Account	10,000	0	0	Sundry Debtors	21,842	0	0
Profit and Loss Account (undistributed balance)	5,000	0	0	Cash at Bank	14,050	0	0
£	182,815	0	0	£	182,815	0	0

Uprichards, Limited.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Issued Capital:—				Freehold Warehouse	32,741	0	0
50,000 Ordinary Shares of £1				Machinery and Plant	12,930	0	0
each, fully paid	50,000	0	0	Patents	2,000	0	0
Sundry Creditors	8,000	0	0	Stock	9,000	0	0
Profit and Loss Account (undistributed balance)	10,000	0	0	Sundry Debtors	10,889	0	0
				Cash at Bank	440	0	0
	£68,000	0	0		£68,000	0	0

The capital of the new company on the basis of the above revised Balance Sheets will be as follows:—

	Total Assets.	Liabilities.	Net Assets.
	£	£	£
Inchiquins, Ltd.	182,815	17,815	165,000
Uprichards, Ltd.	68,000	8,000	60,000
		Capital of the new company =	£225,000

The capital of the new company, issued as fully paid, will be divided as shown above. This means that the shareholders of Inchiquins, Ltd.,

will receive eleven new shares for every ten old shares held, and the shareholders of Uprichards, Ltd., will receive six new shares for every five old shares held. In actual practice, fractions generally arise that cannot be accurately allotted. These shares are therefore sold by the Liquidator, and the proceeds divided proportionately amongst the shareholders entitled to the fractions incapable of allotment. An alternative method is to issue *fractional certificates*. For example, if a shareholder is entitled to one-quarter of a £1 share, a fractional certificate is issued to him with 5s. credited as paid up. This can either be paid up in full by the recipient, or sold.

Sometimes arrangements are made with one or more of the shareholders who agree to purchase all fractions. The individual shareholders are then given provisional "fractional certificates" (carrying no dividend or voting rights) which, if presented within a given time, with other fractions to complete a whole share, will be exchanged for a share certificate. This practice obviates the issue of "partly paid" share certificates.

The initial Balance Sheet of the new company, Soleil d'Or, Ltd., will appear as follows :—

Soleil d'Or, Limited.

BALANCE SHEET, JANUARY 1, 19...

	£	s.	d.		£	s.	d.
Capital :—				Freehold Factory and Warehouse	129,583	0	0
Issued : 225,000 Ordinary Shares				Machinery and Plant	37,415	0	0
of £1 each, fully paid	225,000	0	0	Patents	2,000	0	0
Sundry Creditors	25,815	0	0	Motor Lorries	4,271	0	0
				Stock	30,325	0	0
				Sundry Debtors	32,731	0	0
				Cash at Bank	14,490	0	0
£	250,815	0	0	£	250,815	0	0

NOTE.—The fixed assets are stated at cost price to the new company.

Absorption.—The absorption of one company by another is to all intents identical with the amalgamation of two companies, except that, in the latter case, a new company is usually formed to purchase the assets of the amalgamating companies. When an absorption takes place, the larger company—the absorbing company—actually has or creates sufficient unissued capital to issue shares in satisfaction of the agreed purchase price of the undertaking absorbed. The policy of absorption has been extensively practised in the banking world, the objects being to extend operations, to eliminate competition, and to secure economy in working expenses. Absorption involves either a profit or a loss to the company absorbed, according to whether the price paid by the purchasing company for the assets of the vendor company is greater or less than the values at which those assets stand in the books of the vendor.

Illustration.—Chatenays, Ltd., agreed to absorb the business of Dicksons, Ltd., as on December 31, 19... Chatenays agreed to discharge

Dicksons' liabilities, to pay the expenses of absorption (£2,000), and to take over the assets at their Balance Sheet values. The purchase price was to be satisfied by the issue of twelve £1 shares in Chatenays, Ltd., for every share of £10 in Dicksons, Ltd. The Balance Sheets of the two companies were as follows :—

Chatenays, Limited.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Capital :— Nominal : 400,000 Ordinary Shares of £1 each £400,000				Freehold Warehouse	78,000	0	0
				Machinery and Plant	57,862	0	0
				Goodwill	30,000	0	0
				Stock	21,420	0	0
				Sundry Debtors	39,238	0	0
Issued : 200,000 Ordinary Shares of £1 each	200,000	0	0	Cash at Bank	12,480	0	0
Reserve Account	30,000	0	0	Profit and Loss Account (Balance)	5,000	0	0
Sundry Creditors	14,000	0	0				
£	244,000	0	0	£	244,000	0	0

Dicksons, Limited.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Capital :— 10,000 Ordinary Shares of £10 each	100,000	0	0	Freehold Factory	45,500	0	0
				Machinery and Plant	29,864	0	0
				Stock	19,434	0	0
Sundry Creditors	12,462	0	0	Sundry Debtors	18,462	0	0
Bills Payable	9,538	0	0	Cash at Bank	8,740	0	0
£	122,000	0	0	£	122,000	0	0

The necessary entries in the books of Chatenays, Ltd., are as follows :—

LEDGER.

1 SUNDRY ASSETS. 1

DR. CR.

19...			£	s.	d.				£	s.	d.
Dec. 31	To Balance of Sundry Asset Accounts of old company as per Balance Sheet (other than cash and goodwill but including Profit and Loss Account)	✓	201,520	0	0						
" 31	" Sundry Assets, Dicksons, Ltd. (other than cash)	J. 2	113,260	0	0						
		£	314,780	0	0						

LEDGER—*continued.*

3 SHARE CAPITAL ACCOUNT. 3

Dr.			£	s.	d.				£	s.	d. Cr.
						19... Dec. 31	By Balance	√	200,000	0	0
						" 31	" 120,000 Shares, issued as fully paid as purchase price of Dicksons, Ltd.	J. 2	120,000	0	0
								£	320,000	0	0

5 RESERVE ACCOUNT. 5

Dr.			£	s.	d.				£	s.	d. Cr.
						19... Dec. 31	By Balance	√	30,000	0	0

7 GOODWILL ACCOUNT. 7

Dr			£	s.	d				£	s.	d. Cr.
19... Dec. 31	To Balance (Chatenays)	√	30,000	0	0						
" 31	" Dicksons, Ltd.	J. 2	20,000	0	0						
			£50,000	0	0						

9 SUNDRY CREDITORS. 9

Dr.			£	s.	d.				£	s.	d. Cr.
						19... Dec. 31	By Balance (Chatenays)	√	14,000	0	0
						" 31	" Sundries (Dicksons)	J. 2	22,000	0	0
									£36,000	0	0

11 DICKSONS, LIMITED. 11

Dr.		J.	£	s.	d.			J.	£	s.	d. Cr.
19... Dec. 31	To Fully Paid Shares	2	120,000	0	0	19... Dec. 31	By Sundry Assets ..	2	122,000	0	0
" 31	" Sundry Liabilities	2	22,000	0	0	" 31	" Goodwill Account	2	20,000	0	0
		£	142,000	0	0			£	142,000	0	0

LEDGER—*continued.*

13 ABSORPTION EXPENSES ACCOUNT. 13

Dr.		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Cash	2	2,000	0	0						

15 CASH BOOK. 15

Dr.			£	s.	d.	Cr.		J.	£	s.	d.
19... Dec. 31	To Balance	√	12,480	0	0	19... Dec. 31	By Absorption Expenses	2	2,000	0	0
" 31	" Cash (Dicksons, Ltd.)		8,740	0	0	" 31	" Balance carried down	√	19,220	0	0
			£21,220	0	0				£21,220	0	0
19... Dec. 31	To Balance brought down	√	19,220	0	0						

Chatenays, Limited.

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundries:— Dr.							
	Freehold Factory	1	45,500	0	0			
	Machinery and Plant	1	29,864	0	0			
	Sundry Debtors	1	18,462	0	0			
	Stock	1	19,434	0	0			
	Cash at Bank	15	8,740	0	0			
	To Dicksons, Ltd.	11				122,000	0	0
	For the assets taken over as per agreement, dated December 18, 19...							
" 31	Dicksons, Ltd. .. .. Dr.	11	120,000	0	0			
	To Share Capital Account	3				120,000	0	0
	Being 120,000 shares of £1 each issued as fully paid to the shareholders of Dicksons, Ltd., as purchase price of the company's undertaking as per agreement, dated December 18, 19...							
" 31	Absorption Expenses Account .. .. Dr.	13	2,000	0	0			
	To Cash	15				2,000	0	0
	Being costs of absorption to be written off over three years.							
" 31	Dicksons, Ltd. .. .. Dr.	11	22,000	0	0			
	To Sundry Creditors	9				12,462	0	0
	" Bills Payable	9				9,538	0	0
	For discharge of these liabilities taken over as per agreement, dated December 18, 19...							
" 31	Goodwill Account .. .. Dr.	7	20,000	0	0			
	To Dicksons, Ltd	11				20,000	0	0
	Being amount represented by goodwill included in the purchase.							

[*Continuation of* JOURNAL *on p.* 476.

Chatenays, Limited.

BALANCE SHEET, DECEMBER 31, 19...
(AFTER ABSORPTION.)

		£	s.	d.
Capital:—				
Nominal: 400,000 Ordinary Shares of £1 each	£400,000 0 0			
Issued: 320,000 Ordinary Shares of £1 each		320,000	0	0
Reserve Account		30,000	0	0
Sundry Creditors—				
Chatenays, Ltd. ..	14,000 0 0			
Dicksons, Ltd.	12,462 0 0			
		26,462	0	0
Bills Payable		9,538	0	0
	£	386,000	0	0

	£ s. d.	£	s.	d.
Freehold Property—				
Chatenays, Ltd. ..	78,000 0 0			
Dicksons, Ltd. ..	45,500 0 0			
		123,500	0	0
Machinery and Plant—				
Chatenays, Ltd. ..	57,862 0 0			
Dicksons, Ltd. ..	29,864 0 0			
		87,726	0	0
Goodwill—				
Chatenays, Ltd. ..	30,000 0 0			
Dicksons, Ltd. ..	20,000 0 0			
		50,000	0	0
Stock—				
Chatenays, Ltd. ..	21,420 0 0			
Dicksons, Ltd. ..	19,434 0 0			
		40,854	0	0
Sundry Debtors—				
Chatenays, Ltd. ..	39,238 0 0			
Dicksons, Ltd. ..	18,462 0 0			
		57,700	0	0
Cash at Bank		19,220	0	0
Profit and Loss Account (Chatenays, Ltd.)		5,000	0	0
Absorption Expenses Account		2,000	0	0
	£	386,000	0	0

NOTE.—If the Balance Sheet is laid before a General Meeting, details of the bases of valuation of fixed assets, etc., must be given.

Dicksons, Limited.

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Realisation Account .. .. Dr.	L.F.	122,000	0	0			
	To Sundries:—							
	Freehold Factory	—				45,500	0	0
	Machinery and Plant	—				29,864	0	0
	Sundry Debtors	—				18,462	0	0
	Stock	—				19,434	0	0
	Cash at Bank	—				8,740	0	0
	Being the assets taken over by Chatenays, Ltd., as per agreement dated December 18, 19...							
,, 31	Sundries:— Dr.							
	Sundry Creditors	L.F.	12,462	0	0			
	Bills Payable	—	9,538	0	0			
	To Realisation Account	—				22,000	0	0
	Being liabilities taken over by Chatenays, Ltd., as per agreement dated December 18, 19...							
,, 31	Chatenays, Ltd., Fully Paid Shares Account Dr.	L.F.	120,000	0	0			
	To Realisation Account	—				120,000	0	0
	Being 120,000 fully paid ordinary shares issued by Chatenays, Ltd., in settlement of purchase price as per agreement dated December 18, 19...							

Reconstruction, Amalgamation, Absorption.—These terms, often employed somewhat loosely, appear to confuse some students. It may be useful, therefore, briefly to recapitulate the chief signification of the terms. It may be pointed out in this place, that a limited company has no implied power to promote or acquire other companies, or to dispose of its undertaking unless such power exists under the Memorandum, although, upon liquidation, the liquidator has such power.

Reconstruction.—This term usually, but far from invariably, indicates that trading losses and financial stringency have compelled the company to re-value, or write off, some of its assets, and to reduce its capital to a like extent.

Amalgamation.—This term usually means that all the companies entering into the combination have been liquidated, and that the amalgamated assets have been purchased by a new company formed for the purpose.

Absorption.—This term indicates that a stronger has purchased or absorbed a weaker company, shares in the stronger or absorbing company being allotted to the shareholders of the company absorbed in satisfaction of the purchase price of the absorbed company's assets.

None of the above terms have any precise legal significance, notwithstanding that they are in common use.

Dissentient Shareholders.—In a reconstruction or amalgamation it frequently happens that the assets of the old company are sold for

shares in the new. But a shareholder may be unwilling to accept such shares, especially if, being only partly paid, they involve liability for calls. He is protected by S. 234 (where the scheme is under that section) of the Act of 1929. Provided that he has not voted in favour of the resolution giving the liquidator power to sell the assets for shares, he may by notice in writing, addressed to the liquidator and left at the registered office of the company, within seven days after the passing of the resolution, require the liquidator either to refrain from carrying the resolution into effect or to purchase his interest at a price to be fixed by agreement or arbitration. The Articles cannot deprive him of this right. If the liquidator elects to purchase the dissentient shareholder's interest he must pay the price before the company is dissolved.

If the resolution to sell for shares is not sanctioned by the Court, and an order for winding up the company is made within a year, the special resolution authorising the scheme will not be valid. Where there is any possibility of this occurring, the liquidator should apply for a supervision order.

If the Memorandum contains the necessary power (as it usually does), a company may sell its undertaking for shares before it goes into liquidation; but it cannot divide the proceeds until wound up. Distribution of capital can be made only in a winding up, or by Order of the Court under S. 154.

Where an application has been made to the Court under S. 153 (see p. 453) for the sanctioning of a compromise or arrangement between a company and its members and/or creditors, and it is shown that the compromise or arrangement has been proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies or the amalgamation of any two or more companies, and that under the scheme the whole or any part of the undertaking or the property of any company concerned in the scheme (i.e. a transferor company) is to be transferred to another company (i.e. a transferee company) the Court may make provision for all or any of the following matters:—

(*a*) The transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of any transferor company;

(*b*) The allotting or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person;

(*c*) The continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;

(*d*) The dissolution, without winding up, of any transferor company;

(*e*) The provision to be made for dissentients;

(*f*) Such other matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out (S. 154[1]).

The order of the court itself effects the transfer of any property or liabilities specified, without further formality (S. 154[2]). A copy of the order must be registered with the Registrar of Companies within seven days after the making of the order (S. 154[3]).

Where a scheme or contract involving the transfer of shares or any class of shares in a transferor company to a transferee company, has within four months after the making of the offer in that behalf by the transferee company been approved by the holders of not less than nine-tenths in value of the shares affected, the transferee company may, at any time within two months after the expiration of the said four months, give notice in the prescribed manner (statutory forms are prescribed) to any dissenting shareholder that it desires to acquire his shares, and where such a notice is given, the transferee company shall, unless on an application made by the dissenting shareholder within one month from the date on which the notice was given the Court thinks fit to order otherwise, be entitled and bound to acquire those shares on the terms on which under the scheme or contract the shares of the approving shareholders are to be transferred to the transferee company (S. 155[1]).

Where a notice has been given by the transferee company under the above provision, and the Court has not ordered to the contrary, the transferee company shall, on the expiration of one month from the date on which the notice has been given, or, if an application to the Court by the dissenting shareholder is then pending, after that application has been disposed of, transmit a copy of the notice to the transferor company and pay or transfer to the transferor company the amount or other consideration representing the price payable by the transferee company for the shares which by virtue of this section that company is entitled to acquire, and the transferor company shall thereupon register the transferee company as the holder of these shares (S. 155[2]). Any sums so received by the transferor company must be paid into a separate banking account, and the consideration be held in trust for the persons entitled thereto (S. 155[3]). In this section the expression " dissenting shareholder " includes a shareholder who has not assented to the scheme or contract and any shareholder who has failed or refused to transfer his shares in accordance with the scheme or contract (S. 155 [4]).

Relief from Capital and Transfer Stamp Duty in case of Reconstruction or Amalgamation of Companies.—S. 55, Finance Act, 1927, as amended by S. 31, Finance Act, 1928, and S. 36, Finance Act, 1930, provides relief as follows:—

(1) If in connection with a scheme for the reconstruction of any company or companies, or the amalgamation of any companies it is shown to the satisfaction of the Commissioners of Inland Revenue that there exist the following conditions, that is to say—

(*a*) that a company with limited liability is to be registered, or that since the commencement of this Act a company has been incorporated by letters patent or Act of Parliament, or the nominal share capital of a company has been increased;

(*b*) that the company (in this section referred to as "the transferee company") is to be registered or has been incorporated or has increased its capital with a view to the acquisition either of the undertaking of, or of not less than ninety per cent. of the issued share capital of, any particular existing company;

(*c*) that the consideration for the acquisition (except such part thereof as consists in the transfer to or discharge by the transferee company of liabilities of the existing company) consists as to not less than ninety per cent. thereof—

(i) where an undertaking is to be acquired, in the issue of shares in the transferee company to the existing company or to holders of shares in the existing company; or

(ii) where shares are to be acquired, in the issue of shares in the transferee company to the holders of shares in the existing company in exchange for the shares held by them in the existing company;

then, subject to the provisions of this section—

(A) The nominal share capital of the transferee company, or the amount by which the capital of the transferee company has been increased, as the case may be, shall, for the purpose of computing the stamp duty chargeable in respect of that capital, be treated as being reduced by either—

(i) an amount equal to the amount of the share capital of the existing company in respect of which stamp duty has been paid, or relief has been allowed under the provisions of this section, or, in the case of the acquisition of a part of an undertaking, equal to such proportion of the said share capital as the value of that part of the undertaking bears to the whole value of the undertaking; or

(ii) the amount to be credited as paid up on the shares to be issued as such consideration as aforesaid, and on the shares, if any, to be issued to creditors of the existing company in consideration of the release of debts (whether secured or unsecured) due or accruing due to them from the existing

company or of the assignment of such debts to the transferee company,

whichever amount is the less; and

(B) Stamp duty under the heading "Conveyance or Transfer on Sale" in the First Schedule to the *Stamp Act*, 1891, shall not be chargeable on any instrument made for the purposes of or in connection with the transfer of the undertaking or shares, or on any instrument made for the purposes of or in connection with the assignment to the transferee company of any debts, secured or unsecured, of the existing company. Nor shall any such duty be chargeable under section twelve of the *Finance Act*, 1895, on a copy of any Act of Parliament, or on any instrument vesting, or relating to the vesting of the undertaking or shares in the transferee company:

Provided that—

(*a*) no such instrument shall be deemed to be duly stamped unless either it is stamped with the duty to which it would but for this section be liable or it has in accordance with the provisions of section twelve of the *Stamp Act*, 1891, been stamped with a particular stamp denoting either that it is not chargeable with any duty or that it is duly stamped; and

(*b*) in the case of an instrument made for the purposes of or in connection with a transfer to a company within the meaning of the *Companies* (*Consolidation*) *Act*, 1908,* the provisions of paragraph (B) of this subsection shall not apply unless the instrument is either—

(i) executed within a period of twelve months from the date of the registration of the transferee company or the date of the resolution for the increase of the nominal share capital of the transferee company, as the case may be; or

(ii) made for the purpose of effecting a conveyance or transfer in pursuance of an agreement which has been filed, or particulars of which have been filed, with the registrar of companies within the said period of twelve months; and

(*c*) the foregoing provision with respect to the release and assignment of debts of the existing company shall not, except in the case of debts due to banks or to trade creditors, apply to debts which were incurred less than two years before the proper time for making a claim for exemption under this section.

(2) For the purposes of a claim for exemption under paragraph (B) of subsection (1) of this section, a company which has, in con-

* Now the *Companies Act*, 1929.

nection with a scheme of reconstruction or amalgamation, issued any unissued share capital shall be treated as if it had increased its nominal share capital.

(3) A company shall not be deemed to be a particular existing company within the meaning of this section unless it is provided by the memorandum of association of, or the letters patent or Act incorporating, the transferee company that one of the objects for which the company is established is the acquisition of the undertaking of, or shares in, the existing company, or unless it appears from the resolution, Act or other authority for the increase of the capital of the transferee company that the increase is authorised for the purpose of acquiring the undertaking of, or shares in, the existing company.

(4) In a case where the undertakings of, or shares in, two or more companies are to be acquired, the amount of the reduction to be allowed under this section in respect of the stamp duty chargeable in respect of the nominal share capital or the increase of the capital of a company shall be computed separately in relation to each of those companies.

(5) Where a claim is made for exemption under this section, the Commissioners of Inland Revenue may require the delivery to them of a statutory declaration in such form as they may direct, made in England by a solicitor of the Supreme Court or in Scotland by an enrolled law agent, and of such further evidence, if any, as the Commissioners may reasonably require.

(6) If—

(*a*) where any claim for exemption from duty under this section has been allowed, it is subsequently found that any declaration or other evidence furnished in support of the claim was untrue in any material particular, or that the conditions specified in subsection (1) of this section are not fulfilled in the reconstruction or amalgamation as actually carried out; or

(*b*) where shares in the transferee company have been issued to the existing company in consideration of the acquisition, the existing company within a period of two years from the date, as the case may be, of the registration or incorporation, or of the authority for the increase of the capital, of the transferee company ceases, otherwise than in consequence of reconstruction, amalgamation or liquidation, to be the beneficial owner of the shares so issued to it; or

(*c*) where any such exemption has been allowed in connection with the acquisition by the transferee company of shares in another company, the transferee company within a period of two years from the date of its registration or incorporation or of the authority for the increase of its capital, as the case

may be, ceases, otherwise than in consequence of reconstruction, amalgamation or liquidation, to be the beneficial owner of the shares so acquired;

the exemption shall be deemed not to have been allowed, and an amount equal to the duty remitted shall become payable forthwith, and shall be recoverable from the transferee company as a debt due to His Majesty, together with interest thereon at the rate of five per cent. per annum in the case of duty remitted under paragraph (A) of subsection (1) of this section from the date of the registration or incorporation of the transferee company or the increase of its capital, as the case may be, and in the case of duty remitted under paragraph (B) of the said subsection from the date on which it would have become chargeable if this Act had not passed.

(7) If in the case of any scheme of reconstruction or amalgamation the Commissioners of Inland Revenue are satisfied that at the proper time for making a claim for exemption from duty under subsection (1) of this section there were in existence all the necessary conditions for such exemption other than the condition that not less than ninety per cent. of the issued share capital of the existing company would be acquired by the transferee company, the Commissioners may, if it is proved to their satisfaction that not less than ninety per cent. of the issued capital of the existing company has under the scheme been acquired within a period of six months from the earlier of the two following dates, that is to say—

(*a*) the last day of the period of one month after the first allotment of shares made for the purpose of the acquisition; or

(*b*) the date on which an invitation was issued to the shareholders of the existing company to accept shares in the transferee company;

and on production of the instruments on which the duty paid has been impressed, direct repayment to be made of such an amount of duty as would have been remitted if the said condition had been originally fulfilled.

(8) *In this section, unless the context otherwise requires*—

References to the undertaking of an existing company include references to a part of the undertaking of an existing company.

The expression "shares" includes stock.

PROVISION AS TO STAMP DUTY ON POWERS OF ATTORNEY.

S. 56 (Finance Act, 1927). No instrument chargeable with stamp duty under the heading "Letter or Power of Attorney, and Commission, Factory, Mandate, or other instrument in the nature thereof" in the First Schedule to the *Stamp Act*, 1891, shall be charged with duty more than once by reason only that more persons than one are named in

the instrument as donors or donees (whether jointly, severally or otherwise), of the powers thereby conferred or that those powers relate to more than one matter.

STAMP DUTIES.

The following is an extract from the latest Inland Revenue Notice to Secretaries, etc.:

The Board of Inland Revenue furnish the following information regarding the stamp duties with which secretaries, registrars and other officers of companies are most usually concerned.

Secretaries of companies and others whose office it is to register or enter any instrument chargeable with stamp duty are required to see that such instrument is properly stamped before registration or entry. In any case of doubt the Commissioners of Inland Revenue may be asked to adjudicate upon and assess the duty under the provisions contained in Section 12 of the *Stamp Act*, 1891, and officers responsible for registering instruments should suggest that applicants have recourse to this step whenever it appears to be in any way desirable.

Any person, being the proper officer to enrol, register, or enter in or upon any rolls, books, or records any instrument chargeable with any duty, who enrols, registers, or enters any such instrument not being duly stamped, is liable to a fine of £10.

Persons executing instruments in which all the facts and circumstances affecting their liability to duty, or the amount of such duty, are not fully stated, or who, being employed or concerned in the preparation of any instrument, neglect to set forth such facts and circumstances, are liable to a fine of £10.

Conversion of Business into Limited Company.—The advantages accruing from the conversion of a private business into a limited company have already been considered (*see* p. 261). A company is a separate entity, therefore the conversion must be treated as a sale to an outside party, notwithstanding that no actual change may take place in the management.

The first step in a conversion is to fix the nominal capital for registration. A margin of unissued capital, beyond present needs, should be left for future expansion. The date of the sale, the amount of the goodwill (if any), the advisability of revaluing any of the assets, the payment of the liabilities, the purchase consideration, and the method of its discharge must also be decided. Since *ad valorem* duty will be charged on the book debts, if taken over, it is more usual for the vendors to retain them and to discharge the liabilities. This can be done without disturbing the business, if the new company acts as agent for the vendor in collecting the debts and paying the liabilities. The latest Balance Sheet of the business almost invariably forms the basis for the conversion, subject to any adjustment of book values, of the creation of a Goodwill Account, if deemed desirable.

Illustration.—Messrs. L. and R. Uprichard decide to convert their business into a limited company on December 31, 19... Profits are shared as to three-fifths and two-fifths respectively. The necessary preliminaries for the formation were taken, and the Company was registered as "Uprichards, Ltd.," to take over the business as on January 1st in the following year. The capital was fixed at 100,000 shares of £1 each. The book values of the assets were accepted by the Company, except that Freehold Property was to be revalued at £38,850 and Patents at £500. The Company was to collect the book debts and pay the liabilities of the old firm. Any difference between these amounts was to be paid in cash by the vendors to the Company. The purchase price of the business was to be satisfied by the allotment of fully paid shares to the vendors. The price of the Goodwill was agreed at £15,000, payable in fully paid shares.

The Book Debts were collected in full and the liabilities satisfied on January 31st.

The Balance Sheet of L. and R. Uprichard, as on the date of sale, was as follows :—

L. & R. Uprichard.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital :—					Freehold Property	35,250	0	0
L. Uprichard	£36,000				Machinery and Plant	10,640	0	0
R. Uprichard	20,000				Patents	1,500	0	0
		56,000	0	0	Stock	7,760	0	0
Sundry Creditors		10,685	0	0	Sundry Debtors	14,640	0	0
Bills Payable		4,520	0	0	Cash at Bank	1,415	0	0
		£71,205	0	0		£71,205	0	0

Uprichards, Limited

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundry Assets .. .. Dr.							
	To Vendors	13				59,165	0	0
	Freehold Property	1	38,850	0	0			
	Machinery and Plant	3	10,640	0	0			
	Patents	5	500	0	0			
	Stock	7	7,760	0	0			
	Cash at Bank	C.B. 21	1,415	0	0			
	Being assets of the firm taken over at agreed prices as per Contract for Sale, dated December 15, 19...							
" 31	Goodwill Account .. .. Dr.	11	15,000	0	0			
	To Vendors	13				15,000	0	0
	Being agreed purchase price of the Goodwill as per Contract for Sale.							
" 31	Vendors .. .. Dr.	13	74,165	0	0			
	To Share Capital Account	15				74,165	0	0
	Being 74,165 shares of £1 each issued as fully paid in discharge of the purchase price of the business.							

LEDGER.

1 FREEHOLD PROPERTY. 1

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Sundries	6	38,850	0	0						

3 MACHINERY AND PLANT. 3

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Sundries	6	10,640	0	0						

5 PATENTS ACCOUNT. 5

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Sundries	6	500	0	0						

7 STOCK. 7

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Sundries	6	7,760	0	0						

11 GOODWILL ACCOUNT. 11

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Vendors	6	15,000	0	0						

13 VENDORS' ACCOUNT. 13

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19... Dec. 31	To Share Capital Account	6	74,165	0	0	19... Dec. 31	By Sundry Assets ..	6	59,165	0	0
Jan. 31	" Cash—					" 31	" Goodwill	6	15,000	0	0
	Creditors ..	21	10,685	0	0	Jan. 31	" Cash *re* Debtors	21	14,640	0	0
	Bills	21	4,520	0	0	" 31	" Cash, Balance due	21	565	0	0
		£	89,370	0	0			£	89,370	0	0

15 SHARE CAPITAL ACCOUNT. 15

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
						19... Dec. 31	By Vendors	6	74,165	0	0

21 **CASH BOOK.** 21

Dr.		J.	£	s.	d.	Cr.			£	s.	d.
19... Dec. 31	To Balance	6	1,415	0	0	19... Jan. 31	By Vendors, Cash paid to Sundry Creditors of old firm	13	10,685	0	0
Jan. 31	„ Vendors, Book debts of old firm collected	13	14,640	0	0	„ 31	„ Vendors, Bills Payable met for old firm	13	4,520	0	0
„ 31	„ Vendors, Balance due per agreement	13	565	0	0	„ 31	„ Balance carried down	√	1,415	0	0
		£	16,620	0	0			£	16,620	0	0
19... Dec. 31	To Balance brought down	√	1,415	0	0						

The initial Balance Sheet of the new company would appear as follows :—

Uprichards, Limited.

BALANCE SHEET, JANUARY 1, 19..

	£	s.	d.		£	s.	d.
Capital :— Nominal 100,000 shares of £1 each £100,000				Goodwill at cost	15,000	0	0
				Freehold Property at cost	38,850	0	0
				Machinery and Plant at cost ..	10,640	0	0
Issued: 74,165 shares of £1 each	74,165	0	0	Patents at cost	500	0	0
				Stock	7,760	0	0
				Cash at Bank	1,415	0	0
£	74,165	0	0	£	74,165	0	0

The books of the old firm would be closed by means of a Realisation Account as follows :—

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			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Realisation Account .. .. Dr.	14	56,565	0	0			
	To Sundries :—							
	Freehold Property	2				35,250	0	0
	Machinery and Plant	4				10,640	0	0
	Patents	6				1,500	0	0
	Stock	8				7,760	0	0
	Cash at Bank	26				1,415	0	0
	Being book value of the assets sold to the company as per Contract for Sale dated December 15, 19...							
„ 31	Uprichards, Ltd. .. .. Dr.	24	74,165	0	0			
	To Realisation Account	14				74,165	0	0
	Being the agreed purchase consideration for sale of the business as per contract dated December 15, 19...							
„ 31	Shares in Uprichards, Ltd. .. .. Dr.	16	74,165	0	0			
	To Uprichards, Ltd.	24				74,165	0	0
	Being 74,165 shares of £1 each issued as fully paid in discharge of the purchase price of the business.							

[*For continuation of Journal see p. 487*

JOURNAL—*continued.* **18**

			Dr. £	s.	d.	Cr. £	s.	d.
Dec. 31	Realisation Account .. .. Dr. To L. Uprichard .. .. ,, R. Uprichard .. .. Being respective shares of the partners in the profit resulting from the sale of the business	14 10 12	17,600	0	0	 10,560 7,040	 0 0	 0 0
,, 31	Sundries Dr. To Shares in Uprichards, Ltd. .. .. L. Uprichard .. .. R. Uprichard .. .. For division of the purchase consideration for the sale of the business.	 16 10 12	 46,899 27,266	 0 0	 0 0	 74,165	 0	 0
Jan. 31	Sundry Creditors .. .. Dr. Bills Payable .. .. Dr. To Uprichards, Ltd. .. .. Being sundry liabilities paid by the company as per Contract for Sale.	18 22 24	10,685 4,520	0 0	0 0	 15,205	 0	 0
,, 31	Uprichards, Ltd. .. .. Dr. To Sundry Debtors .. .. Being book debts of the firm collected by the company as per Contract for Sale.	24 20	14,640	0	0	 14,640	 0	 0
,, 31	Uprichards, Ltd. .. .. Dr. To L. Uprichard .. .. ,, R. Uprichard .. .. Being cash paid by partners individually in ratio of 3 : 2 to company to discharge excess of liabilities over debtors as per Contract for Sale.	24 10 12	565	0	0	 339 226	 0 0	 0 0

LEDGER.

Freehold Property.

2 Dr. Cr. **2**

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance	√	35,250	0	0	19... Dec 31	By Realisation Account	18	35,250	0	0

Machinery and Plant.

4 Dr. Cr. **4**

			£	s.	d.			J.	£	s.	d.
19 .. Dec. 31	To Balance	√	10,640	0	0	19... Dec. 31	By Realisation Account	18	10,640	0	0

Patents.

6 Dr. Cr. **6**

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance	√	1,500	0	0	19... Dec. 31	By Realisation Account	18	1,500	0	0

LEDGER—*continued.*

8 STOCK.

Dr.			£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Balance	√	7,760	0	0	19... Dec. 31	By Realisation Account	J. 18	7,760	0	0

10 L. UPRICHARD, CAPITAL ACCOUNT. 10

Dr.		J.	£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Shares	18	46,899	0	0	19... Dec. 31	By Balance	√	36,000	0	0
						" 31	" Share of Profit on Sale of Business	J. 18	10,560	0	0
						Jan 31	" Uprichards, Ltd.	18	339	0	0
		£	46,899	0	0			£	46,899	0	0

12 R. UPRICHARD, CAPITAL ACCOUNT. 12

Dr.		J.	£	s.	d.				£	s.	d. Cr.
19... Dec. 31	To Shares	18	27,266	0	0	19... Dec. 31	By Balance	√	20,000	0	0
						" 31	" Share of Profit on Sale of Business	J. 18	7,040	0	0
						Jan. 31	" Uprichards, Ltd.	18	226	0	0
		£	27,266	0	0			£	27,266	0	0

14 REALISATION ACCOUNT. 14

Dr.		J.	£	s.	d.			J.	£	s.	d. Cr.
19... Dec. 31	To Sundry Assets ..	18	56,565	0	0	19... Dec. 31	By Purchase Price ..	18	74,165	0	0
" 31	" Balance carried down, being profit on sale of the business		17,600	0	0						
		£	74,165	0	0			£	74,165	0	0
19... Dec. 31	To L. Uprichard, $\frac{3}{5}$ths	18	10,560	0	0	19... Dec. 31	By Balance brought down	√	17,600	0	0
" 31	" R. Uprichard, $\frac{2}{5}$ths		7,040	0	0						
		£	17,600	0	0			£	17,600	0	0

16 SHARES IN UPRICHARDS, LIMITED. 16

Dr.		J.	£	s.	d.			J.	£	s.	d. Cr.
19... Dec. 31	To 74,165 fully paid shares of £1 each	18	74,165	0	0	19... Dec. 31	By L. Uprichard ..	18	46,899	0	0
						" 31	" R. Uprichard ..	18	27,266	0	0
		£	74,165	0	0			£	74,165	0	0

LEDGER—*continued.*

18 SUNDRY CREDITORS. **18**

Dr.			£	s.	d.	Cr.			£	s.	d.
19... Jan. 31	To Uprichards, Ltd.	J. 18	10,685	0	0	19... Dec 31	By Balance	√	10,685	0	0

20 SUNDRY DEBTORS. **20**

Dr.			£	s.	d.	Cr.			£	s.	d.
19... Dec. 31	To Balance	√	14,640	0	0	19... Jan. 31	By Uprichards, Ltd.	J. 18	14,640	0	0

22 BILLS PAYABLE. **22**

Dr.			£	s.	d.	Cr.			£	s.	d.
19... Jan. 31	To Uprichards, Ltd.	J. 18	4,520	0	0	19... Dec. 31	By Balance	√	4,520	0	0

24 UPRICHARDS, LIMITED. **24**

Dr.		J.	£	s.	d.	Cr.		J.	£	s.	d.
19... Dec. 31	To Purchase Price	18	74,165	0	0	19... Dec. 31	By Fully Paid Shares	18	74,165	0	0
Jan. 31	„ Sundry Debtors	18	14,640	0	0	Jan. 31	„ Sundry Creditors	18	10,685	0	0
„ 31	„ Balance carried down	√	565	0	0	„ 31	„ Bills Payable ..	18	4,520	0	0
		£	89,370	0	0			£	89,370	0	0
19... Jan. 31	To Sundries	18	565	0	0	19... Jan. 31	By Balance brought down	√	565	0	0

26 Dr. CASH BOOK. Cr. **26**

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance	√	1,415	0	0	19... Dec. 31	By Realisation Account	18	1,415	0	0

Where an arrangement is made, as in the above example, for the purchasing company to collect the debtors and pay the liabilities, it is undesirable for the company to enter these items in their books, except by way of memoranda, until cash has passed. Separate columns may be kept in the Cash Book, or a separate Cash Book be used, to record the receipts and payments on behalf of the vendors, the individual items being posted to the old personal accounts, handed over for the purpose. The totals can be posted periodically to the vendors' account, thus showing the balance due to or from them. Bad Debts and Discounts, allowances, etc., are thus automatically adjusted through the vendors' account, and the books of the company itself show the true position, i.e. that they are doing something for the vendors, with whom they have a personal account.

Profits Prior to Incorporation.—When a limited company is registered in order to purchase an established business, it is necessary to fix a definite date when the undertaking is to be taken over. If that date is after the incorporation of the company, no difficulty arises. The agreed date of purchase, however, is usually that upon which the last accounts of the business were prepared. The prospectus of the new company will then state, e.g., "That the business of B. Blank & Sons will be taken over by the company as on January 1, 19..." It will be clear that a period of time may elapse between that date and the date of incorporation of the company owing to the time required for carrying out the necessary formalities for the formation and registration of the new company. That being so, there must be two periods during which profits are being earned, viz. (*a*) prior to incorporation, and (*b*) subsequent to incorporation. The company does not exist until it has been legally incorporated, and obviously until it is incorporated it cannot earn profits. It follows, therefore, that the profits earned anterior to incorporation are of a capital nature, and not available for division, since the company, in law, takes over the assets on the date of incorporation, in such a case, not on an earlier date. Any profits earned prior to that date result in an increase of assets, which are taken over *as assets*, i.e. they are taken as capital.

In view of these facts, it becomes necessary to apportion the profits between these two periods, and that portion which accrued prior to incorporation should be used to reduce the purchase price of the business. Goodwill, if any, suggests itself as the most suitable item for reduction. Failing this, Land and Buildings, or similar fixed asset, should be credited with the amount available. If there are no assets that can be suitably reduced, the amount should be taken to a Capital Reserve Account.

Undoubtedly, the best course to pursue would be to take stock and prepare accounts for the two periods. But, in the majority of cases, the preparation of two sets of accounts, and a double stock-taking, would prove too great and too expensive a task. An approximate apportionment of the profits as between the two periods is the usual compromise. Circumstances, and the nature of the business, must suggest the equitable basis for the apportionment. Where profits are evenly earned during the year, a time basis, though not very scientific, is reasonable. But a time basis would not be justified in cases where the trade is a "season" trade, or varies greatly month by month. In such cases, the special circumstances must be taken into account.

A method frequently adopted is to apportion the gross profit on the turnover of the whole period between the two periods, and to credit each period with the proportion of the gross profit on the sales belonging to it. The gross profit thus arrived at is debited with the charges set out in the Profit and Loss Account, apportioned on a time basis, or as they were actually incurred during the two periods,

if such treatment is reasonable. In most cases, it is probably more scientific to confine apportionments on the "time" basis to standing charges which do not vary with the turnover, treating all other items on their individual merits.

Objections can be raised to both methods, but they are approximate enough for practical purposes.

Illustration 1.—Dicksons, Ltd., was incorporated on March 31, 19.., and acquired the business of Abel Chatenay as from the previous January 1. The accounts of the company at the close of the first year to December 31st disclosed the following results :—

	£
Gross Profit for the year	40,000
Sundry Profit and Loss Charges and Expenses	8,000
Managing Director's Salary, Directors' Fees, and other charges applicable to the company only	4,200
Sales for the year	400,000
Sales, January 1st to March 31st	80,000
Sales, April 1st to December 31st	320,000
Net Profit for the year	30,220

The percentage of gross profit remained unchanged throughout the year. For the period January 1st to March 31st the proportion of gross profit

$$= \frac{80{,}000}{400{,}000} \text{ of } £40{,}000 = £8{,}000.$$

For the period April 1st to December 31st the proportion of gross profit

$$= \frac{320{,}000}{400{,}000} \text{ of } £40{,}000 = £32{,}000.$$

The apportionment of the profits as between the two periods will then be arrived at as follows :—

THE LIMITED COMPANY'S PERIOD, MARCH 31 TO DEC. 31, 19...

	£	s.	d.		£	s.	d.
To Proportion of Profit and Loss Expenses	6,000	0	0	By Share of Gross Profit	32,000	0	0
„ Expenses wholly applicable to the company	4,200	0	0				
„ Balance, being profit available for division	21,800	0	0				
	£32,000	0	0		£32,000	0	0

The net profit of the complete year is £30,220, and the proportion applicable to the Limited Company as shown above is £21,800. There therefore remains £8,420, representing the capital profit which accrued prior to the incorporation of the company. As explained above, this sum is available in reduction of some suitable asset, or as a Capital Reserve

Illustration 2.—Blanks, Ltd., was incorporated on March 31, 19.., to acquire the old-established business of Uprichards & Son as on January 1st of the same year. The sales for the complete year to

December 31st were £80,000; the sales to March 31st were £20,000; the sales from April 1st to December 31st being £60,000. The net profit for the year was £20,000.

The Capital Profit (January 1st to March 31st) was therefore :—

$$\frac{20,000}{80,000} \text{ of } £20,000 = £5,000.$$

The profit available for distribution (March 31st to December 31st) was :—

$$\frac{60,000}{80,000} \text{ of } £20,000 = £15,000.$$

In the case of a manufacturing company, it may be advisable to base the apportionment of the profit between the two periods according to the volume and value of the sales. It may also be necessary, in such a case, to charge each period, as far as possible, with the various debts and charges properly applicable to them. In this connection a statement should be prepared as under :—

APPORTIONMENT OF PROFITS FOR THE YEAR ENDED ....

	Prior to Incorporation.			Subsequent to Incorporation.				Prior to Incorporation.			Subsequent to Incorporation.		
	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Salaries, Management Charges, General Charges and Depreciation	23,060	0	0	7,041	0	0	Gross Profit (based upon sales) ..	33,620	0	0	18,480	0	0
Bad Debts	1,020	0	0	200	0	0							
Interest on Debentures				2,300	0	0							
Directors' Fees, and Secretary's Salary				1,525	0	0							
Advertising	1,645	0	0	2,480	0	0							
Balance carried down	7,895	0	0	4,934	0	0							
£	33,620	0	0	18,480	0	0	£	33,620	0	0	18,480	0	0
							By Balance brought down	7,895	0	0	4,934	0	0

The profit applicable to the first period, as shown in the above statement (£7,895), would be carried to Reserve; the profit for the second period (£4,934) being available for distribution.

Loss Prior to Incorporation.—The author has known a purchasing company to be so unfortunate as to experience a loss on trading for the period prior to incorporation. The effect of such a loss is to increase the purchase price of the business, and the amount of the loss must be added to a suitable asset account (e.g. Goodwill Account), or, preferably, be taken to a Suspense Account to be dealt with when profits become available for its reduction.

Valuation of Shares.—The Articles of private companies frequently provide that, in case of need, the shares are to be valued by the auditors of the company. Such a valuation may become necessary (*a*) upon the death of a shareholder, (*b*) should any member desire to dispose of his holding. In the latter case, the Articles of the majority of private companies restrict the offer of shares, in the first place, to existing members of the company. The usual bases for the valuation of shares are: (1) the profit basis, (2) the asset basis as disclosed by the Balance Sheet.

(1) *Profit Basis.*—The average annual profits for from three to five years are ascertained and capitalised, and increased by any Reserve or other fund accumulated out of profits prior to inclusion in the ascertained average.

Illustration.—Blanks, Ltd., have an issued capital of £20,000, and a Reserve Fund of £4,000 representing undivided profits. The average profits for the past five years amount to £4,000. It is assumed that in a business of the type carried on by the company an investor in its ordinary shares would look for a return of 10 %. The average annual profits on this basis capitalise at £40,000, plus the reserve of £4,000, or £44,000 in all. The value of the 20,000 shares may therefore be taken at £2 4s. per share.

(2) *Asset Basis.*—This rests upon the value of the assets in which the capital is invested, as disclosed in the Balance Sheet. By this method the question to be answered is: What funds would be available for the shareholders after all possible claims against the company have been settled?

Illustration.—The following is the Balance Sheet of Rayon d'Or, Ltd.:—

BALANCE SHEET.

	£	s.	d.		£	s.	d.
Capital:—				Goodwill	4,000	0	0
Issued: 20,000 shares of £1 each,				Sundry Assets	37,000	0	0
fully paid..	20,000	0	0	Cash	3,000	0	0
5 % Debentures	10,000	0	0				
Reserve Account	4,000	0	0				
Sundry Creditors	9,000	0	0				
Profit and Loss Account (Balance)	1,000	0	0				
£	44,000	0	0	£	44,000	0	0

The Articles provide that Goodwill Account is to be revalued periodically on the basis of two years' purchase of the average annual profits for the four years following the last valuation, and that any appreciation or depreciation in the asset is to be adjusted through the Reserve Account. On this basis of valuation just taken, the goodwill of Rayon d'Or, Ltd., is found to be worth £3,000. Assuming that the remaining assets are of the value stated in the Balance Sheet, and that no other liabilities exist, it would appear that the shareholders are entitled to:—

		£
Capital		20,000
Reserve Account	£4,000	
Less Depreciation in value of Goodwill	1,000	
		3,000
Profit and Loss Account		1,000
Total Net Assets		£24,000

On this basis the shares may be taken to be worth £1 4s. per share.

The student must understand that the above illustrations deal with the question of valuation in its simplest form. In most actual cases, other considerations must be taken into account, e.g. (*a*) the nature of the security afforded by the assets; (*b*) the prospects of a steady return of income from the shares; (*c*) whether the death or retirement of the shareholder will prejudice the earning capacity of the company; (*d*) the adequacy of the reserves; (*e*) the nature of the secret reserves (if any); (*f*) the inclusion of fictitious assets in the Balance Sheet; (*g*) what rights attach to the preference shares, cumulative and non-cumulative; (*h*) whether there are any arrears of dividend, or any unissued preference shares, or any special market considerations that may affect the company's future prospects, and so forth.

Valuing Unquoted Shares.—The accountant is not infrequently called upon to value unquoted shares in private and public companies for probate purposes. The bases of valuation outlined above are equally suitable for such purposes. No definite Inland Revenue rules are laid down for such valuations. The market price of the shares for probate purposes must be "the price which, in the opinion of the Commissioners of Inland Revenue, the shares would fetch if sold in the open market on the terms that the purchaser should be entitled to be registered as the holder of the shares" (*Re Henry Jameson, deceased: Attorney-General* v. *Jameson and others*, [1905]). It must be noted that, for Estate Duty purposes, an *open market* for the shares must be assumed to exist in the terms of Sec. 7 (5), *Finance Act*, 1894, as interpreted by the rule laid down in the case quoted above, notwithstanding that a company may have Articles restricting the sale of its shares.

Annual Report and Accounts.—Every company *must* keep proper books of account with respect to—

(*a*) All sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place.

(*b*) All sales and purchases of goods by the company.

(*c*) The assets and liabilities of the company (S. 122[1]).

If any person being a director of a company fails to take all reasonable steps to secure compliance by the company with the above requirements, or has by his own wilful act been the cause of any default by

the company thereunder, he is, in respect of each offence, liable on summary conviction to imprisonment for a term not exceeding six months, or to a fine not exceeding £200. Imprisonment is only to to be imposed where the Court considers that the offence was committed wilfully (S. 122 [3]).

Moreover, by S. 274, if where a company is wound up it is shown that proper books of account were not kept by the Company throughout the period of two years immediately preceding the commencement of the winding up, every director, manager or other officer who was knowingly a party to or connived at the default of the company shall, unless he shows that he acted honestly or that in the circumstances in which the business of the company was carried on the default was excusable, be liable on conviction on indictment to imprisonment for a term not exceeding one year, or on summary conviction to imprisonment for a term not exceeding six months. For the purposes of this section, proper books of account shall be deemed not to have been kept in the case of any company if there have not been kept such books or accounts as are necessary to exhibit and explain the transactions and financial position of the trade or business of the company, including books containing entries from day to day in sufficient detail of all cash received and cash paid, and, where the trade or business has involved dealings in goods, statements of the annual stocktakings and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.

From an examination of the above statutory provisions, it will be obvious that every company must keep adequate books of account, and that only by means of a complete set of books on the double-entry system can such adequacy be assured.

The books of account must be kept at the registered office of the company or at such other place as the directors think fit, and shall at all times be open to inspection by the directors (S. 122 [2]).

Profit and Loss Account and Balance Sheet.—The directors must at some date not later than eighteen months after the incorporation of the company and subsequently once at least in every calendar year lay before the company in general meeting a Profit and Loss Account or, in the case of a company not trading for profit, an Income and Expenditure Account for the period, in the case of the first account, since the incorporation of the company, and, in any other case, since the preceding account, made up to a date not earlier than the date of the meeting by more than nine months, or, in the case of a company carrying on business or having interests abroad, by more than twelve months. The Board of Trade may, if they think fit for any special reason, extend these periods (S. 123[1]).

The directors must cause to be made out in every calendar year,

and to be laid before the company in general meeting, a Balance Sheet as at the date to which the Profit and Loss Account (or Income and Expenditure Account, if appropriate) is made up (S. 123[2]).

It has already been stated that a copy of the Balance Sheet and relevant documents must form part of the Annual Return to be registered with the Registrar by public companies (S. 110).

Directors' Report.—There must be attached to every Balance Sheet laid before the company in general meeting as mentioned above, a report by the directors with respect to (*a*) the state of the company's affairs, (*b*) the amount, if any, which they recommend should be paid by way of dividend, and (*c*) the amount, if any, which they propose to carry to the reserve fund, general reserve or reserve account shown specifically on the Balance Sheet or to a reserve fund, general reserve or reserve account to be shown specifically on a subsequent Balance Sheet (S. 123[2]) (see also p. 360).

It must be observed that appropriations to reserves *not* shown or not to be shown separately on the Balance Sheet need not be mentioned, thus Secret Reserves can still be created.

Most companies combine a copy of their annual accounts with the notice convening the Annual General Meeting and the Directors' Report on the Accounts. Page 1 of the folder contains the Report; page 2, the Profit and Loss Account and Balance Sheet; and the notice convening the meeting appears as an indorsement. Nowadays, Directors' Reports tend to extreme brevity, and are usually confined to (*a*) A short summary of the year's trading, with or without comparison with previous years; (*b*) a statement showing the balance available for distribution, and its proposed allocation; (*c*) the names of the retiring Directors and Auditors, and the fact that they are eligible for and desire re-election. The usual character of these documents may be gathered from the subjoined specimen, which is an actual report except for the substitution of imaginary names.

(*Typical Directors' Report.*)

Blanks, Limited.

REPORT OF THE DIRECTORS.

The Directors have pleasure in submitting to the Shareholders the Balance Sheet as at December 31, 19.., and the Profit and Loss Account for the year ended on that day.

	£
The Profit and Loss Account shows a profit of	108,589
To which is added the amount brought forward from last year	21,479
Making a total of	£130,066

The Directors propose to appropriate this sum as follows :—

	£
Dividend on 7 % Preference Shares for the half-year to December 31st	3,500
Interim Dividend at the rate of 15 % per annum on the Ordinary Shares paid July 18th	18,000
To pay a further dividend on the Ordinary Shares at the rate of 25 % per annum, making 20 % free of Income Tax for the year ended December 31st	30,000
To place to Reserve (making the Fund £250,000)	20,000
To write off the balance of new issue of Capital Expenses Account	3,785
To Staff Superannuation Fund	10,000
To Income Tax Reserve	20,000
To carry forward to next account	24,781
	£130,066

In accordance with the articles of association, Mr. A. N. Other retires, but, being eligible, offers himself for re-election as a Director.

The auditors, Messrs. Abel Checker & Co., also retire, but offer themselves for re-election.

By order of the Board,
W. H. Bury,
Secretary.

Contents of Balance Sheet.—The Balance Sheet must exhibit the following information:—

(i) A summary of the authorised share capital.
(ii) A summary of the issued share capital
(iii) A summary of the liabilities.
(iv) A summary of the assets.
(v) Such particulars as are necessary to disclose the general nature of the liabilities and assets, and to distinguish between the amounts respectively of the fixed assets and of the floating assets;
(vi) A statement of how the values of the fixed assets have been arrived at.
(vii) A statement under separate headings, so far as they are not written off, of:

(*a*) The preliminary expenses of the company;
(*b*) Any expenses incurred in connection with any issue of shares or debentures;
(*c*) If it is shown as a separate item in or is otherwise ascertainable from the books of the company, or from any contract for the sale or purchase of any property to be acquired by the company, or from any documents in the possession of the company relating to the stamp duty payable in respect of any such contract or the conveyance of any such property, the amount of the goodwill and of any patents and trade-marks as so shown or ascertained.

(viii) Where any liability is secured otherwise than by operation of law on any assets of the company, a statement that that liability is so secured, but it is not necessary to specify the assets on which the liability is secured (S. 124).

(ix) The aggregate holding of shares in subsidiary companies; and the aggregate indebtedness from such companies and to such companies (S. 125) (see p. 465).

(x) Capital Redemption Reserve Fund created on the redemption of Redeemable Preference Shares.

(xi) Details of Redeemable Preference Shares and the date on or before which they are, or are to be liable to be redeemed (S. 46).

(xii) So far as it has not been written off, the commission paid in respect of any shares or debentures and any discount on debentures (S. 44), and discount on shares issued at a discount (S. 47).

(xiii) Share capital on which and rate at which interest during construction, etc., has been paid out of capital under S. 54. (This *might* appear in the Profit and Loss Account, but is better shown in the Balance Sheet.)

(xiv) Redeemed Debentures available for reissue (S. 75[3]).

(xv) Amount of loans for the purchase of fully paid shares in accordance with a scheme for such purchase by Trustees for the benefit of employees, or to employees to purchase shares for their own beneficial ownership (S. 45).

(xvi) Any Reserve, General Reserve or Reserve Fund which the Directors' Report specifies (S. 123[2]).

Either the Balance Sheet or the Profit and Loss Account must also disclose:—

(xvii) The amount of any loans made during the period of the accounts to any Director or Officer, including loans repaid during the period, and the amount of any loans previously made and still outstanding, unless the loans were made by a moneylending company (e.g. a bank) in the ordinary course of business, or the loan is to an employee and does not exceed £2,000 and is certified by the directors to be in accordance with the company's practice in respect to such loans (S. 128).

(xviii) The total of the amount paid to directors as remuneration for their services by the company or any subsidiary company (excluding the managing director and any sums paid in respect of other offices held by directors) (S. 128).

For outline of a Balance Sheet see pp. 80-81.

Signing of Balance Sheet.—The Balance Sheet must be signed on behalf of the board by two of the directors, or the sole director and the auditor's report must be attached and be read before the company in general meeting and be open to inspection by any member (S. 129[1]).

Circulation of Balance Sheet.—Except in the case of a private company, a copy of every Balance Sheet, including every document required by law to be annexed thereto (this provision includes the Directors' Statement *re* Subsidiary Companies' Profits and Losses and the Directors' Report, but does not include the Profit and Loss Account), which is to be laid before the company in general meeting, and a copy of the auditor's report must, not less than seven days before the date of the meeting, be sent to all persons entitled to receive notices of general meetings. Any member or debenture holder may demand a free copy of each of these documents. In the case of a private company any member is entitled to demand a copy on payment of a charge not exceeding sixpence per hundred words; such copy must be furnished within seven days of his demand (S. 130).

Profit and Loss Account.—The statement prepared to determine the net profit or revenue, or the net loss, as the case may be, for the period covered by the account, is, with the great majority of commercial Joint Stock Companies, termed the Profit and Loss Account. Assurance companies, companies working under the double-account system, and some Trust, Finance, and Land Companies employ the term "Revenue Account."

The construction of these accounts has been fully discussed in Chapter III, and three model solutions to company examination questions demanding the preparation of Trading, and Profit and Loss Accounts, and Balance Sheet, will be found on pp. 506–17. The student must understand, however, that it is a rare experience to find in the published accounts of companies anything like the detail given in these worked examples. It is exceptional for a limited company to publish a Trading or Manufacturing Account. The usual company Profit and Loss Account as published is secretive in the extreme, and is usually confined, on the credit side, to the "gross profit" brought from the Trading Account and the receipts from Transfer Fees; and on the debit side to Directors' and Auditors' and Debenture Trustees' fees, legal expenses, debenture interest, interim dividends, and the like. The "gross profit" shown in these accounts is usually arrived at as explained on p. 501. If the *true* gross profit is brought down, then the whole of the General Expenses are debited here in one total.

The balance thus arrived at is increased or diminished, as the case may be, by the balance brought forward from the previous year, and the account thus shows either (1) the final amount available for distribution, or (2) the total amount standing to the debit of Profit and Loss Account at the date of its preparation. A specimen of a published Profit and Loss Account is shown on p. 500.

The growing tendency to curtail the information afforded to shareholders regarding the trading results of their undertaking is in strong contrast with the detail required by the statutory form of accounts demanded from Assurance Companies, and Parliamentary Companies

under the double-account system. Full disclosure of details in the accounts of commercial companies may sometimes be harmful, but too great reticence may become an abuse. The provisions of the Act of 1929 ensure that secrecy shall not be carried too far.

(*Typical Profit and Loss Account, as published by Limited Companies.*)

Uprichards, Limited.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
To Directors' Fees	5,950	0	0	By Balance from Trading Account*	86,546	10	2
,, Debenture Trustees' Fees ..	600	0	0	,, Transfer Fees	342	13	6
,, Debenture Interest	18,000	0	0	,, Interest on Investments ..	4,612	10	0
,, Balance carried down	66,951	13	8				
£	91,501	13	8	£	91,501	13	8
To Reserve Account	5,000	0	0	By Balance brought down	66,951	13	8
,, Interim Dividend, Ordinary Shares (paid July 3rd).. ..	20,800	0	0	,, Balance from last year	12,486	4	2
,, 6 % Preference Dividend to June 30th	6,000	0	0				
,, Income Tax Reserve	22,000	0	0				
,, Staff Pensions Fund	5,000	0	0				
,, Balance carried down	20,637	17	10				
£	79,437	17	10	£	79,437	17	10
				By Balance brought down	20,637	17	10

* This is obviously not the true "Gross Profit" (*see* pp. 499 and 501).

Some companies do not circulate a Profit and Loss Account, but content themselves with a rather more elaborate statement of the item in the Balance Sheet than is necessary when a Profit and Loss Account is published. Below is given an actual specimen of the statement of Profit and Loss balance in a Balance Sheet when no separate account was circulated. A Profit and Loss Account must, as already stated, be laid before the general meeting.

PROFIT AND LOSS ACCOUNT :—		£	£ s. d.
Balance, being profit for the year		142,675	
Balance from last year		32,498	
	£	175,173	
Less Transfer to Reserve	25,000		
Debenture Interest	12,500		
Preference Dividend	36,000		
Interim Dividend on Ordinary Shares	15,000		
		88,500	
			£86,673 0 0

When Profit and Loss Accounts are published in the abbreviated form described above, it is clear that the balance of gross profit brought

from Trading Account and carried to Profit and Loss Account must have been arrived at after charging many items which are not Trading Account items, but which, in the ordinary course, would appear in the Profit and Loss Account, e.g. depreciations, provision for bad debts, and similar charges. It is the author's experience that students are sometimes confused by the misleading use of the term "Gross Profit" in the published accounts of some companies. It must be clearly understood that the gross profit of a commercial undertaking can only be accurately determined in the manner described in Chapter III, and that solutions submitted in answer to examination questions should be prepared on the lines there laid down.

Appropriation Account.—It is particularly necessary to prepare this section of the Profit and Loss Account in the case of limited companies, since, otherwise, the account will not show at a glance the net result of the year's working. Some students, when answering company examination exercises, present the Profit and Loss Account in one continuous account, and include in it the balance brought from last year, and any dividends that may have been paid. Marks are lost by this treatment, which fails to show the profit for the current year, or to differentiate between charges against profits and appropriations from profits.

The method recommended is: Carry the net profit or loss for the current year to the appropriate section; increase or diminish this sum by the balance brought forward from last year; debit any preference dividends, and interim ordinary dividends paid; any transfers to Reserve; any amounts written off goodwill; Directors' or Managing Directors' Commission on net profits; income tax chargeable on profits, and similar items; all of which are appropriations out of profits, and not charges against them.* The final balance of the section will show the amount of undistributed profit available for allocation as dividends, or further reserves, or to be carried forward. The Directors' proposals with regard to the balance shown will form part of their Report attached to the accounts.

The student may be here reminded that recommendations as to dividend need the sanction of the shareholders, and should appear in the Directors' Report only. They must *not* appear as a charge against the available balance, a caution which some examination candidates (and even limited companies!) would do well to observe.

Illustration.—Uprichards, Ltd., was registered with a capital of £200,000 7 % Preference Stock and 200,000 Ordinary Shares. After providing for debenture interest and the preference dividend for the half-year to June 30th, the profit shown by the Profit and Loss Account for the year ended December 31, 19.., amounted to £42,648. The balance brought forward from the previous year was £11,892, making an available balance

* Commissions are, of course, chargeable against profits for the purposes of Taxation. We are not here concerned with this aspect.

of £54,540. Cash at the Bank totalled £9,862. For the service of the dividend, £20,000 was borrowed from the Bank.

The Directors decided to make the following recommendations to the shareholders :—

	£
To pay the half-year's dividend to December 31st on the 7 % Preference Shares	7,000
To transfer to the Reserve Account, making that account £50,000	10,000
To write off the balance of the Debenture Issue Expenses Account	3,975
To pay a dividend of 10 % free of tax on the Ordinary Shares	20,000
To carry forward to next year	13,565
	£54,540

Assume that the above recommendations have been carried into effect; that Income Tax is 4s. in the £; and that the dividends were duly paid.

The necessary entries are as follows :—

Uprichards, Limited.

LEDGER.

1 PROFIT AND LOSS ACCOUNT. 1

(Appropriation Section.)

Dr. Cr.

		L.F.	£	s.	d.				£	s.	d.
19... Dec. 31	To Dividend on 7% Preference Shares	7	7,000	0	0	19... Dec. 31	By Balance brought down	√	42,648	0	0
" 31	" Dividend on Ordinary Shares	9	20,000	0	0	" 31	" Balance from last year £45,892 *Less* Dividends paid 34,000	√	11,892	0	0
" 31	" Reserve Account	5	10,000	0	0						
" 31	" Debenture Issue Expenses Account	3	3,975	0	0						
" 31	" Balance carried down	√	13,565	0	0						
		£	54,540	0	0			£	54,540	0	0
						19... Dec. 31	By Balance brought down	√	13,565	0	0

3 DEBENTURE ISSUE EXPENSES ACCOUNT. 3

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance ..	√	3,975	0	0	19... Dec. 31	By Profit and Loss Account	1	3,975	0	0

LEDGER—*continued*

5 RESERVE ACCOUNT. 5

Dr.											Cr.
			£	s.	d.	19...			£	s.	d.
						Dec. 31	By Balance	✓	40,000	0	0
						,, 31	,, Profit and Loss Account	1	10,000	0	0
								£	50,000	0	0

7 7 % PREFERENCE SHARES, DIVIDEND ACCOUNT. 7

Dr.											Cr.
19...			£	s.	d.	19...			£	s.	d.
Dec. 31	To Income Tax Account	11	1,400	0	0	Dec. 31	By Profit and Loss Account	1	7,000	0	0
,, 31	,, Cash	C.B. 14	5,600	0	0						
			£7,000	0	0				£7,000	0	0

9 ORDINARY SHARES, DIVIDEND ACCOUNT. 9

Dr.											Cr.
19...			£	s.	d.	19...			£	s.	d.
Dec. 31	To Cash	C.B. 14	20,000	0	0	Dec. 31	By Profit and Loss Account	1	20,000	0	0

11 INCOME TAX ACCOUNT. 11

Dr.											Cr.
			£	s.	d.	19...			£	s.	d.
						Dec. 31	By Preference Dividend Account..	7	1,400	0	0

13 CASH BOOK. 13

Dr.											Cr.
19...			£	s.	d.	19...			£	s.	d.
Dec. 31	To Balance	✓	9,862	0	0	Dec. 31	By Sundry Preference Shareholders	7	5,600	0	0
,, 31	,, Cash, Loan from Bank ..	15	20,000	0	0	,, 31	,, Sundry Ordinary Shareholders ..	9	20,000	0	0
						,, 31	,, Balance carried down	✓	4,262	0	0
		£	29,862	0	0			£	29,862	0	0
19...											
Dec. 31	To Balance brought down	✓	4,262	0	0						

LEDGER—*continued.*

15 BANK LOAN. 15

(Secured by the Deposit of Deeds.)

Dr.			£	s.	d.				Cr. £	s.	d.
						19.. Dec. 31	By Cash	C.B. 13	20,000	0	0

The above Ledger accounts have been opened by direct transfers from the Profit and Loss Account, as would be the case in practice in the majority of cases. From a technical and theoretical point of view, it would be more correct to open the Ledger accounts by means of a Journal entry.

Comparative Profit and Loss Accounts.—The intelligent company book-keeper will take pride in furnishing his Directors with the maximum of useful information. Particularly informative is a tabulated set of accounts showing the figures for two or more years, the increases or decreases in the various items, and the percentages of gross and net profit, and of the principal items of expenditure, to the turnover of the business. Too much elaboration will defeat itself, but there can be no question that, prepared as suggested, comparative accounts often prove invaluable. Such accounts are, of course, for the Directors' own use, and not for publication. The precise form in which the Accounts are to be published will be determined by the Directors.

Necessity for Exactitude.—In some particulars, there is even more need for exactitude in the accounts of limited companies than in those of a sole trader. For example, in providing for waste and depreciation, the private trader can adjust the values of his assets at any time by crediting the asset account and debiting his Capital Account with the amount of the desired provision. A limited company cannot do this. There is the further consideration that the ownership of the shares of a limited company is constantly changing. Hence the rights of the shareholders must be equitably adjusted within the confines of each financial period.

The Balance Sheet.—The construction of Balance Sheets has already been fully discussed in Chapter V, and little is left to mention here. As already stated, Balance Sheets are prepared in two recognised forms—the double-account system, and the single-account system. The former system, applicable chiefly to Parliamentary Companies, is dealt with in Chapter XIII. The ordinary double-entry system of book-keeping results in the single-account Balance Sheet common to most Joint Stock Companies. This is illustrated on p. 509.

With the exception of certain Statutory Companies, no company is bound to any particular form of Balance Sheet, so long as the details required by the Act are properly stated. Perusal of a collection of published Balance Sheets will reveal great diversity of form, which will support the conviction, which by this time the student will doubtless

have formed, that there can be no standardisation of company Balance Sheets. The majority of companies marshal their assets in the order of their permanence and unrealisability, and range against them, as far as possible, the capital and relevant liabilities. The alternative method of marshalling the assets in the order of their realisability and the liabilities in the order in which they must be met is suitable for, and is usually adopted by, banks, discount houses, and similar concerns. Provided that the student is consistent throughout the Balance Sheet, he may adopt either the ascending or the descending scale of realisability, and will be equally correct.

So far as the ordinary manufacturing and trading assets and liabilities are concerned, there is little or no difference between the construction of the Balance Sheet of a company and that of a private firm engaged in a similar business. What difference there is results from the duty imposed upon a company to protect its capital from diminution, except by the statutory methods already explained. Profits earned, or losses incurred, cannot be added to, or deducted from, the Capital Account as in the case of a private firm. They must be separately stated as the balance of the Profit and Loss Account. This statement is a platitude, and attention is again called to the fact, only because some candidates, when dealing with company accounts, carry the profit or the loss for the year to the Share Capital Account as though the accounts were those of a private trader. The capital of a company as subscribed by its shareholders remains a *permanent* figure, until it is increased or reduced by the methods laid down in law.

The following undertakings must present their accounts in the form prescribed by Statute :—

Undertaking.	Source of Prescribed Form.
(*a*) Railway Companies	*Railway Companies (Accounts and Returns) Act*, 1911, First Schedule. (Modified by an order of the Minister of Transport dated 27th December, 1928.)
(*b*) Life Assurance Companies .	*Assurance Companies Act*, 1909.
(*c*) Gas Companies	*Gas Works Clauses Act*, 1871, Schedule B.
(*d*) Gas Companies (Urban Authorities)	As prescribed by their Provisional Orders.
(*e*) Electric Light Companies ..	As prescribed by the Board of Trade.
(*f*) Building Societies Friendly Societies	As prescribed by the Registrar of Friendly Societies.
(*g*) Hospitals	All hospitals desirous of participating in the distribution of King Edward VII's and other hospital funds must adopt the form of accounts prescribed by the Committee.

Limited companies must present their accounts at least once annually. Banks issue half-yearly statements (S. 131). Railways now present annual accounts, in place of the half-yearly accounts required under the old regulations.

LIMITED COMPANY EXAMINATION QUESTION.

INTERMEDIATE STAGE.

(Royal Society of Arts.)

Berkshire Contractors, Ltd., was registered in 19.. with a nominal capital of £100,000, divided into 100,000 shares of £1 each, of which 75,000 shares had been issued and fully called.

The Trial Balance of the Company, as on December 31, 19.., was as follows :—

TRIAL BALANCE.

	DR. £	CR. £
Share Capital Account		75,000
Freehold Works	25,200	
Machinery and Plant	42,860	
Loose Tools	1,880	
Contracts Executed		76,842
Purchases (Stores and Materials)	24,787	
Workmen's Wages	36,974	
Office Salaries	2,796	
Directors' Fees	750	
Repairs to Machinery and Plant	976	
Rates and Insurance (Works, £2,268; Office, £141)	2,409	
Office Expenses	1,527	
Reserve Account		3,000
Profit and Loss Account Balance (January 1, 19..)		891
Sundry Debtors	17,800	
Sundry Creditors		10,647
Returns	296	1,242
Carriage Inwards	1,576	
Carriage Outwards	941	
Discount Account (Balance)	397	
Cash in hand	1,284	
Bank Overdraft		6,684
General Expenses (Works, £2,976; Office, £201)	3,177	
Interest and Bank Charges	424	
Bad Debts Reserve (January 1, 19..)		850
Stock (Stores and Materials, January 1, 19..)	7,896	
Office Furniture	680	
Preliminary Expenses Account (Balance)	526	
	£175,156	£175,156

You are required to prepare Working and Profit and Loss Accounts for the year ended December 31, 19.., and a Balance Sheet as on that date.

Before preparing these accounts the following matters must be taken into consideration :—(*a*) On December 31st the following valuations were made : Stock (stores and materials), £3,741 ; Value of work done on uncompleted contracts on hand, £3,000. (*b*) Depreciation is to be provided as follows : Machinery and Plant, 10 % ; Office Furniture, 5 % ; Loose Tools, 20 %. (*c*) The Reserve for Bad Debts is to be further increased by a sum equal to ½ % on the Sundry Debtors. (*d*) Reserve £250 for fees due to Directors. (*e*) Insurance paid in advance amounted to : Works, £226 ; Office, £15. (*f*) The balance of the Preliminary Expenses Account is to be written off.

Solution to Intermediate Stage Examination Question.

Berkshire Contractors, Limited.

WORKING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr. 19...			£	s.	d.	19..			£	s.	d. Cr
Jan. 1	To Stock		7,896	0	0	Dec. 31	By Contracts completed	£76,842 0 0			
Dec. 31	" Purchases	£24,787 0 0					Less Returns	296 0 0	76,546	0	0
	Less Returns	1,242 0 0	23,545	0	0						
" 31	" Wages		36,974	0	0	" 31	" Work done on uncompleted Contracts ..	£3,000 0 0			
" 31	" Repairs to Plant		976	0	0	" 31	" Stock	3,741 0 0	6,741	0	0
" 31	" Rates and Insurance		2,042	0	0						
" 31	" Carriage Inwards		1,576	0	0						
" 31	" General Expenses		2,976	0	0						
" 31	" Balance, being Gross Profit carried to Profit and Loss Account		7,302	0	0						
		£	83,287	0	0			£	83,287	0	0

Berkshire Contractors, Limited.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19 ...

Dr.		£	s.	d.		Cr.	£	s.	d.
19... Dec. 31	To Salaries	2,796	0	0	19... Dec. 31	By Balance brought down from Working Account	7,302	0	0
" 31	" Rates and Insurance	126	0	0	" 31	" Balance carried down, being Net Loss for year	5,421	0	0
" 31	" Office Expenses	1,527	0	0					
" 31	" Carriage	941	0	0					
" 31	" Discount Account Balance	397	0	0					
" 31	" Interest and Bank Charges	424	0	0					
" 31	" Directors' Fees	1,000	0	0					
" 31	" Depreciation:—								
	Machinery and Plant, 10 % .. £4,286 0 0								
	Office Furniture, 5 % .. 34 0 0								
	Loose Tools, 20 % .. 376 0 0	4,696	0	0					
" 31	" Reserve for Bad Debts (Additional)	89	0	0					
" 31	" Preliminary Expenses (Balance)	526	0	0					
" 31	" General Expenses	201	0	0					
	£	12,723	0	0		£	12,723	0	0
19... Dec. 31	To Balance brought down	5,421	0	0	19.. Dec 31	By Balance brought forward from last year	891	0	0
					" 31	" Balance carried down	4,530	0	0
		£5,421	0	0			£5,421	0	0
19... Dec. 31	To Balance brought down	4,530	0	0					

Berkshire Contractors, Limited.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.
Capital :—				
Nominal :				
100,000 Shares of £1 each	£100,000 0 0			
Issued :				
75,000 Shares of £1 each, fully paid ..		75,000	0	0
Sundry Creditors	£10,647 0 0			
Directors' Fees	250 0 0			
		10,897	0	0
Reserve Account		3,000	0	0
Bank Overdraft		6,684	0	0
	£	95,581	0	0

		£	s.	d.
Freehold Works		25,200	0	0
Machinery and Plant ..	£42,860 0 0			
Less Depreciation ..	4,286 0 0			
		38,574	0	0
Loose Tools	1,880 0 0			
Less Depreciation ..	376 0 0			
		1,504	0	0
Office Furniture	680 0 0			
Less Depreciation ..	34 0 0			
		646	0	0
Stock—				
Stores and Materials	3,741 0 0			
Uncompleted Contracts	3,000 0 0			
		6,741	0	0
Sundry Debtors	17,800 0 0			
Less Reserve for Bad Debts	939 0 0			
		16,861	0	0
Insurance paid in advance		241	0	0
Cash in hand		1,284	0	0
Profit and Loss Account (Balance)		4,530	0	0
	£	95,581	0	0

NOTE.—The exact basis of valuation of the fixed assets must be stated in the Balance Sheet laid before the company in General Meeting.

LIMITED COMPANY EXAMINATION QUESTION.

Advanced Stage.

(Royal Society of Arts.)

On January 1, 19.., John Laing, a cigarette manufacturer, converted his business into a private limited company under the style of J. Laing & Co., Ltd. The Nominal Capital of the company consisted of 65,000 shares of £1 each; 50,000 of these shares were issued as fully paid to J. Laing and his nominees as the purchase price of the business. During the year £5,000 was advanced by J. Laing as a loan to the company at 6 %, and was secured by the issue of £8,000 5 % Debentures as collateral.

In addition to the above, the following balances appeared in the company's books as on December 31st :—

War Loan (5 %), £506; Machinery and Plant, £7,870; Machinery and Plant (Additions during the year), £3,680; Purchases, £124,621; Purchases Returns, £2,841; Clearing and Dock Charges, £584; Duty on Tobacco, £212,622; Freight and Carriage Inwards, £740; Stock (January 1st), £48,961; Furniture and Fittings, £1,875; Manufacturing Wages, £14,864; Machinery Repairs, £638; Cash in hand, £68; Tobacco Licence, £11; Sales, £410,129; Sales Returns, £4,842; Electric Power, £358; Rent, Rates, and Water (Factory £750, Office £120), £870; Office Expenses, £224; Advertising, £30,000; Motor Lorries, £1,795; Carriage Outwards, £2,048; Management Expenses, Interest, etc., £1,967; Travellers' Salaries and Commission, £5,026; Interest on War Loan, £14; Machinery Sold during the Year, £200; Directors' and Auditors' Fees, £1,200; Office Salaries, £2,142; Discount Account (Debit Balance), £8,764; Removal Expenses, £1,264; Bad Debt Reserve (January 1st), £1,268; Motor Maintenance Expenses, £584; Sundry Creditors, £17,898; Sundry Debtors, £17,840; Bank Overdraft, £5,682; Bills Payable, £3,865; Preliminary Expenses Account, £933.

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended December 31st, and a Balance Sheet as on that date.

When preparing these accounts, the following particulars must be taken into consideration :—

(*a*) Provide for depreciation as follows: Machinery and Plant, 20 %; Additions to Machinery and Plant, 10 %; Furniture and Fittings, 20 %.

(*b*) Carry forward to next year, 20 % of Advertising, two-thirds of Preliminary Expenses, and half the Removal Expenses.

(*c*) Reserve £2,000 for Bad and Doubtful Debts and 10 % on the gross amount of the Sundry Debtors for Discounts.

(*d*) Wages £424, and Office Salaries £78, had accrued due as on December 31st. Management Expenses paid in advance amounted to £187.

(*e*) On December 31st, Stock was valued at £62,974, and Motor Lorries at £1,120.

Solution of Advanced Stage Examination Question.

Messrs. John Laing & Co., Limited.

MANUFACTURING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

DR. CR.

		£	s.	d.			£	s.	d.
To Stock		48,961	0	0	By Sales	£410,129 0 0			
,, Purchases	£124,621 0 0				*Less* Returns ..	4,842 0 0			
Less Returns ..	2,841 0 0						405,287	0	0
		121,780	0	0	,, Stock		62,974	0	0
,, Clearing and Dock Charges		584	0	0					
,, Duty on Tobacco		212,622	0	0					
,, Freight and Carriage Inwards		740	0	0					
,, Manufacturing Wages		15,288	0	0					
,, Machinery Repairs		638	0	0					
,, Tobacco Licence		11	0	0					
,, Electric Power		358	0	0					
,, Rent, Rates, and Water		750	0	0					
,, Balance carried to Profit and Loss Account		66,529	0	0					
	£	468,261	0	0		£	468,261	0	0

Messrs. John Laing & Co., Limited.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..

Dr.		£	s	d		£	s.	d.	Cr.
To *Rent, Rates, and Water*		120	0	0	By Balance brought from Manufacturing Account	66,529	0	0	
,, Office Expenses		224	0	0	,, Interest on War Loan	14	0	0	
,, Advertising		24,000	0	0					
,, Carriage Outwards		2,048	0	0					
,, Management Expenses, Interest, etc.		1,780	0	0					
,, Travellers' Salaries and Commission		5,026	0	0					
,, Directors' and Auditors' Fees		1,200	0	0					
,, Office Salaries		2,220	0	0					
,, Discount		8,764	0	0					
,, Removal Expenses		632	0	0					
,, Motor Maintenance Expenses		584	0	0					
,, Preliminary Expenses		311	0	0					
,, Reserve for Bad Debts, December 31st, 19..	£2,000 0 0								
Less Reserve, January 1st, 19..	1,268 0 0								
		732	0	0					
,, Reserve for Discounts		1,784	0	0					
,, Depreciation :—									
Machinery and Plant (20 %)	£1,534 0 0								
Machinery and Plant additions (10 %)	368 0 0								
Furniture and Fittings (20 %)	375 0 0								
Motor Lorries (Valuation)	675 0 0								
		2,952	0	0					
,, Balance carried down		14,166	0	0					
	£	66,543	0	0	£	66,543	0	0	
					By Balance brought down	14,166	0	0	

NOTES.—(1) The War Loan has evidently been held for less than one year.

(2) The difference between the book value and the written-down value of the machine sold should be adjusted in the Plant Account. Depreciation has been written off for the year *after* eliminating this machine.

Messrs. John Laing & Co., Limited

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.
Capital:—				
Nominal:				
65,000 Shares of £1 each	£65,000 0 0			
Issued:				
50,000 Shares of £1 each, fully paid		50,000	0	0
Loan (Secured by issue of £8,000 5 % Debentures) . ..		5,000	0	0
Sundry Creditors	£17,898 0 0			
Wages £424, Salaries £78	502 0 0			
		18,400	0	0
Bills Payable		3,865	0	0
Bank Overdraft		5,682	0	0
Profit and Loss Account (Balance)		14,166	0	0
	£	97,113	0	0

		£	s.	d	£	s.	d.
Machinery and Plant . ..	£7,870 0 0						
Less Sales	200 0 0						
	7,670 0 0						
Less Depreciation (20 %) ..	1,534 0 0						
		6,136	0	0			
Additions during the year ..	3,680 0 0						
Less Depreciation (10 %)	368 0 0						
		3,312	0	0			
					9,418	0	0
Furniture and Fittings		1,875	0	0			
Less Depreciation (20 %)		375	0	0			
					1,500	0	0
Motor Lorries		1,795	0	0			
Less Depreciation (as per valuation).. ..		675	0	0			
					1,120	0	0
Stock					62,974	0	0
Sundry Debtors		17,840	0	0			
Less Bad Debts Reserve ..	£2,000 0 0						
Reserve for Discounts ..	1,784 0 0						
		3,784	0	0			
					14,056	0	0
War Loan					506	0	0
Cash in hand					63	0	0
Suspense Accounts.—							
Advertising		6,000	0	0			
Removal Expenses		632	0	0			
Preliminary Expenses		622	0	0			
Management Expenses		187	0	0			
					7,441	0	0
				£	97,113	0	0

NOTE.—The exact basis of valuation of the fixed assets must be stated in the Balance Sheet laid before the company in general meeting

LIMITED COMPANY EXAMINATION QUESTION.

Advanced Stage.

(*Royal Society of Arts.*)

Uprichards, Ltd., a manufacturing company, was registered in 19.. with a Nominal Capital of £100,000, divided into 50,000 Ordinary Shares of £1 each and 50,000 7 % Cumulative Preference Shares of £1 each.

The company was formed to purchase an old-established business, and assets valued at £30,000 were taken over from the Vendor, to whom 20,000 Ordinary Shares of £1 each were issued as fully paid, together with a cash payment of £20,000.

As on June 30, 19.., 20,000 Ordinary Shares and 20,000 Preference Shares had been issued to the public, and fully subscribed. 15s. per share had been called and paid up on the Ordinary Shares, with the exception of the last call of 2s. 6d. per share on 1,000 shares. The Preference Shares had been fully called and paid up.

On January 1st of the same year 100 6 % Debentures of £100 each were issued at 96, and were fully subscribed and paid up. The cost of this issue, which was £120, had not been written off.

In addition to the balances represented by the above, the following balances were extracted from the books of the company as on June 30, 19.. :—

Machinery and Plant, £12,300 ; Staff Superannuation Fund, £5,500 ; Office Salaries, £3,876 ; Directors' Fees, £2,000 ; 5 % War Loan (investment of Superannuation Fund), £5,500 ; Fixtures, Fittings, and Furniture (Office), £500 ; Carriage, Purchases, £378 ; Carriage, Sales, £416 ; Factory Power, £568 ; Lighting and Heating (Factory £126, Office £70), £196 ; Freehold Factory, £7,892 ; Freehold Factory, Additions during the year, £1,262 ; Manufacturing Wages, £29,684 ; Manufacturing Expenses, £1,929 ; Stock (at beginning of the year), £42,842 ; Rates and Insurance (Factory £1,826, Office £110), £1,936 ; Purchases, £109,861 ; Sales, £156,453 ; Returns Inwards, £942 ; Returns Outwards, £1,042 ; Discount Account (Credit Balance), £428 ; Bank Loan, £3,000 ; Cash in hand, £126 ; Bank Overdraft, £1,824 ; Sundry Creditors, £40,706 ; Sundry Debtors, £28,960 ; Office Expenses, £1,294 ; Repairs to Factory Buildings, £1,372 ; Transfer Fees, £12 ; Apprentices' Fees, £500 ; Bad Debts, £462 ; Profit and Loss Account (Debit Balance from last year), £8,462 ; Reserve for Bad Debts (at beginning of the year), £800 ; Company's Contribution to Superannuation Fund, £600 ; Interest and Bank Charges, £196 ; Audit Fee, £250 ; Bills Payable, £4,784 ; Motor Lorries, £3,800 ; Loose Tools, £1,800.

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended June 30, 19.., and a Balance Sheet as on that date.

When preparing these accounts the following matters must be taken into consideration :—

(*a*) Depreciation is to be provided as follows : Motor Lorries, 15 % ; Plant and Machinery, 10 % ; Office Fixtures, Furniture, etc., 5 %.

(*b*) The unexpired insurance was : Factory £87, and Office £9.

(*c*) The Reserve for Bad Debts is to be made up to a sum equivalent to 5 % on the Sundry Debtors.

(*d*) An amount of £48 paid to an injured workman, and included in Manufacturing Wages, was recoverable under an Employers' Liability Insurance policy.

(*e*) The following valuations were made as on June 30, 19.. : Stock £36,891 ; Loose Tools, £1,562.

(*f*) The Debenture Interest due, as on June 30, 19.., has not been provided for.

Solution of Advanced Stage Examination Question.

Uprichards, Limited.

MANUFACTURING ACCOUNT FOR THE YEAR ENDED JUNE 30, 19...

Dr. | Cr.

19...			£	s.	d.	19...			£	s.	d.
Jan. 1	To Stock		42,842	0	0	June 30	By Sales ..	£156,453 0 0			
June 30	,, Purchases	£109,861 0 0					*Less* Returns	942 0 0	155,511	0	0
	Less Returns	1,042 0 0	108,819	0	0	,, 30	,, Apprentices' Fees		500	0	0
,, 30	,, Carriage (Purchases)		378	0	0	,, 30	,, Stock		36,891	0	0
,, 30	,, Factory Power		568	0	0						
,, 30	,, Lighting and Heating		126	0	0						
,, 30	,, Manufacturing Wages		29,636	0	0						
,, 30	,, Manufacturing Expenses ..		1,929	0	0						
,, 30	,, Rates and Insurance		1,739	0	0						
,, 30	,, Repairs to Factory		1,372	0	0						
,, 30	,, Balance carried to Profit and Loss Account		5,493	0	0						
		£	192,902	0	0			£	192,902	0	0

Uprichards, Limited.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED JUNE 30, 19...

Dr.					£	s.	d.			£	s.	d.
19...								19...		Cr		
June 30	To Office Salaries				3,876	0	0	June 30	By Balance brought from Manufacturing Account	5,493	0	0
,, 30	,, Directors' Fees				2,000	0	0	,, 30	,, Discount Account (Balance)	428	0	0
,, 30	,, Carriage (Sales)				416	0	0	,, 30	,, Transfer Fees.	12	0	0
,, 30	,, Lighting and Heating				70	0	0	,, 30	,, Balance carried down	6,343	0	0
,, 30	,, Rates and Insurance				101	0	0					
,, 30	,, Office Expenses				1,294	0	0					
,, 30	,, Bad Debts				462	0	0					
,, 30	,, Reserve for Bad Debts:—											
	June 30, 19	£1,448	0	0								
	Less July 1, 19..	800	0	0								
					648	0	0					
,, 30	,, Contribution to Superannuation Fund				600	0	0					
,, 30	,, Interest and Bank Charges				196	0	0					
,, 30	,, Audit Fee				250	0	0					
,, 30	,, Interest on Debentures (6 months)				300	0	0					
,, 30	,, Depreciation:—											
	Machinery and Plant, 10 % ..	£1,230	0	0								
	Fixtures and Furniture, 5 % ..	25	0	0								
	Motor Lorries, 15 %	570	0	0								
	Loose Tools (as per valuation) ..	238	0	0								
					2,063	0	0					
				£	12,276	0	0		£	12,276	0	0
19...								19..				
June 30	To Balance brought down				6,343	0	0	June 30	By Balance carried down	14,805	0	0
,, 30	,, Balance from last year				8,462	0	0					
				£	14,805	0	0		£	14,805	0	0
19...												
June 30	To Balance brought down				14,805	0	0					

EXAMINATION QUESTIONS.

1. The directors of a limited company forfeited 1,000 Ordinary Shares of £1 each owing to non-payment of the final call of 10s. per share. The shares were subsequently reissued to another shareholder for a cash payment of 22s. 6d. per share.

(1) Are these proceedings *intra vires*?

(2) What steps should you take to enable you to arrive at a decision?

(3) How should the transactions be dealt with in the Balance Sheet which you are asked to certify? (*Chartered Accountants.*)

2. You are instructed by the directors of a limited company to examine and initial as correct all new share certificates before they are submitted to them for signature and sealing.

State in detail how you would proceed, and what books and documents you would examine. (*Chartered Accountants.*)

3. Compare and contrast the Balance Sheets necessary in (*a*) Private Partnership; (*b*) Private Limited Company; (*c*) Public Limited Company. (*Royal Society Arts.*)

4. When auditing the accounts of Hugh Dickson, Ltd., you find the following Journal entry :—

		£	£
Sundry Shareholders	Dr.	100	
To Interest Account			100
For interest at 6 % on calls in arrear.			

Do you approve of this entry? If so, under what conditions? (*Chartered Accountants.*)

5. A limited company, registered on March 31st, takes over the assets and liabilities of a trading concern as on January 1st. The profits for the six months to June 30th were £5,000. How would you deal with this sum on closing the books on June 30th? Is the profit available for distribution? (*Chartered Accountants.*)

6. A limited company was incorporated on April 15, 19.., to take over the business of a vendor firm as from December 31st previous. The Agreement for Sale was entered into by the vendors with a trustee for the intended company on March 31st, and was expressly referred to, and its adoption by the company provided for, in the Articles of Association. It contained provisions that all the profits of the business as from December 31, 19.., should belong to the company, and that the vendors should continue trading in the usual way for the benefit of the company until completion, and be indemnified and account accordingly. The agreement was adopted on April 30th, and completion took place on May 31, 19... The accounts for the year show a net profit for the whole year of £12,000, and the Directors proposed to divide the whole as dividend. What considerations govern the determination of the amount distributable? (*Chartered Accountants.*)

7. A limited company is formed to buy a property from B for £50,000; £25,000 in cash and £25,000 in shares. The Capital is £75,000 in 75,000 shares of £1 each. 55,000 shares are issued, 5s. payable on application, 5s. on allotment, 5s. on first call, and 5s. on final call.

The purchase money, £25,000, is paid, and the consideration shares are allotted to B.

The preliminary expenses, £2,200, are paid by the company. Shareholders holding 820 shares fail to pay the final call, and the shares are forfeited under the Articles of Association.

State the Cash Book, Journal, and Ledger entries necessary to record the facts. (*Incorporated Accountants.*)

8. Chatenays, Ltd., have accumulated a Reserve Account of £50,000.

The Nominal Capital of the Company consists of 300,000 shares of £1 each, of which 200,000 shares have been issued and fully paid up. The Directors propose to distribute the Reserve Account by the issue of one fully paid share for every four shares held. What is your opinion of this proposal? Give the entries necessary in order to record the new issue of shares in the Company's books and Balance Sheet. (*Royal Society Arts.*)

9. The Exotic Mining Company, Ltd., with an Authorised Capital of £50,000, undertook on June 1, 19.., to buy the "Exotic" and "Eldorado" gold mining claims from the General Agency Company, Ltd., for £10,000, payable as to £1,000 in cash, as to £4,000 in fully paid Ordinary Shares, taken at par, and as to £5,000 in 6 % First Mortgage Debentures.

On June 7, 19.., the Company offered for subscription 40,000 £1 Ordinary Shares at a premium of 2s. per share, payable 5s. per share (including 2s. premium) on application, 5s. per share on allotment, and the balance of 12s. per share on July 15, 19...

Applications were received for 35,950 shares, all of which were allotted on June 10, 19... All allotment moneys were duly paid on June 14, 19...

The purchase agreement was carried out on June 10, 19.., the requisite allotments of shares and debentures and the payment of cash then being made.

All shareholders, except one holding 100 shares, duly paid the calls due on July 15th.

The shares belonging to the defaulting member were declared to be forfeited by the Board on July 31st, and were reissued by the Board on August 7th to the chairman (the Hon. Hugo Porter, M.P.), on his paying in cash the 12s. per share left unpaid by the original allottee.

Pass these transactions through the Company's books of account, and prepare a Balance Sheet at their conclusion. (*London Chamber Commerce.*)

10. The following are Balance Sheets of two Companies, A and B, on June 30, 19.. :—

Company A.	£	£
Share Capital, fully paid	149,500	
Forfeited Shares Account	125	
Debentures	40,000	
Plant and Machinery		37,500
Freehold Property		43,000
Bank Account		2,000
Goodwill		40,000
Sundry Creditors	5,875	
Sundry Debtors		25,000
Stock		68,000
Profit and Loss Account	20,000	
	£215,500	£215,500

Company B.	£	£
Share Capital	40,000	
Debentures	3,000	
Calls in arrear		500
Plant and Machinery		2,500
Freehold Property		2,000
Debtors and Creditors	25,000	22,500
Stock		18,000
Profit and Loss Account		16,500
Goodwill		6,000
	£68,000	£68,000

Company A decides to take over Company B, and agrees to discharge the liabilities and debentures and take over all the assets, the consideration being £1,200 cash and £30,000 shares in Company A, issued as fully paid up. The calls in arrear are worthless, and the shares were forfeited by the Directors of Company A prior to amalgamation. Company B is to pay its own costs of liquidation.

Draw up a Balance Sheet of the new Company as the result of the incorporation. (*Incorporated Accountants.*)

11. The Rex Company, Ltd., agreed to purchase from Alfred Pratt the assets and goodwill of his business, which were as follows: Freeholds, £3,000; Plant, £8,000; Goodwill, £7,000; Stock, £2,000 = Total Assets of £20,000. Payment was made on November 1, 19.., as to £15,000 in 5 % Debentures, and the balance in Ordinary shares of £1 each, valued at a premium of 5s. each. Show the necessary entries in the books of the Company to record the transactions. (*Central Association Accountants.*)

12. A limited company is formed to purchase an existing business with a nominal capital of £200,000, one-half in Ordinary and one-half in 5 % Preference Shares of £1 each. 60,000 of the Ordinary Shares are issued at a premium of 5s. per share, the Preference Shares being all issued at par; 5s. per share being payable on application and 10s. on allotment in each case. £20,000 6 % Debentures are underwritten at 98 %. On account of the purchase money of £54,000 a sum of £8,000 is paid in discharge of the liabilities of the vendor, and the following assets taken over: Stock-in-trade, £12,000; Book Debts, £20,000; Machinery and Plant, £6,000.

Journalise the entries necessary for recording the purchase in the books of the company. (*Incorporated Accountants.*)

13. On January 1, 19.., a company, with a Nominal Capital of £20,000, divided into 10,000 Ordinary Shares of £1 each, and 1,000 6 % Preference Shares of £10 each, was formed to acquire the business of Albert Durand. It was agreed to allot as fully paid to the vendor, as purchase consideration of the assets acquired, 5,000 Ordinary Shares and 500 Preference Shares. On January 5, 19.., the balance of the Ordinary Shares was issued to the public at a premium of 5s. per share, and 75 % of this issue was duly applied for, the terms of subscription being 10s. per share (including the premium) on application, 7s. 6d. per share on allotment, and the balance on March 31, 19...

The company carried out its agreement with Albert Durand, and went to allotment on January 12th. All cash due on application and allotment was paid with the exception of that due on allotment of 500 shares to Victor Verdier. These shares were forfeited by resolution of the Directors on March 15, 19..., and were reissued on March 22, 19.., to Hugh Dickson on payment of the amount due on the shares.

You are required to show how these transactions would appear in the books of the company, assuming that the call due on March 31, 19.., has been made, but that no cash has been received in respect of it. (*London Chamber Commerce.*)

14. Simcox and Westby's Balance Sheet at December 31, 1910, showed the following figures: Land and Works, £120,000; Stocks and Work in progress, £70,000; Patents, Licences, etc., £10,000; Book Debts, £60,000; Cash at Bankers and in hand, £40,000; Bills Receivable, £10,000; Trade and Cash Creditors, £100,000.

They sold the business to a company (which was formed with a Share Capital of £200,000, divided into 100,000 Ordinary and 100,000 Preference Shares of £1 each, and a Mortgage Debenture Capital of £100,000) for £300,000, to be satisfied by the issue to them of the whole of the Ordinary Shares, 50,000 of the Preference Shares, £50,000 Debentures, and the balance in cash.

The balance of the Preference Shares (at par) and of the Debentures (at 105) were issued to and taken up and paid for by the public as follows :—

	Preference Shares.	Debentures.
On application	2s.	25 %
On allotment	8s.	40 %
On March 31, 1911	10s.	40 %

Underwriting and preliminary expenses amounted to £16,000.

Make the necessary entries in the company's books, and prepare the opening Balance Sheet. (*Chartered Accountants.*)

15. Make the necessary Journal entries to record the following transactions of a limited company :—

(1) *January* 1, 19. . .—The company purchased from vendors Plant and Machinery valued at £5,000, Stock-in-trade valued at £2,500, and Patent Rights valued at £3,000.

(2) *January* 10, 19. . .—The company allotted to vendors, in part payment of purchase of these assets, 800 fully paid Ordinary Shares of £10 each, and issued 25 Mortgage Debentures of £100 each in satisfaction of the balance of purchase money.

(3) *January* 15, 19. . .—The company allotted to applicants 1,000 Ordinary Shares of £10 each, having received on same date £2 per share, the amount payable on application and allotment.

(4) *February* 15, 19. . .—First call of £2 per share made on 1,000 Ordinary Shares.

(5) *February* 20, 19. . .—Payment of first call received in full.

(6) *March* 1, 19. . .—The company received £2,500 in respect of Book Debts due to vendors, agreed to be collected on their behalf. Vendors agreed to accept 30 Mortgage Debentures of £100 each in payment thereof, and these Debentures were issued to them on this date.

(7) *April* 1, 19. . .—Certain shareholders being desirous of paying up the balance due on their shares pending further calls, the company agreed to allow them 5 % per annum interest on the calls paid in advance. £3,000 was received on this date from shareholders under this arrangement.

(8) *April* 15, 19. . .—The company applied the sum of £2,300 in redeeming 20 Debentures of £100 each at a premium of 10 % with £100 interest thereon to date of redemption.

In addition to the entries in the Books of Account, state briefly what other entries must be made in the records of the company in respect of the above transactions. (*Chartered Accountants.*)

16. The Esk Vale Lumber Company, Ltd., agreed to purchase the business of O. Henry, timber merchant, as on January 1, 19. . . O. Henry's Balance Sheet on that date was as follows :—

Liabilities.	£	Assets.	£
Sundry Creditors	2,500	Land and Buildings (subject to Mortgage *contra*) ..	30,000
Bills Payable	6,000	Fixed Plant and Machinery	10,000
Loan on Mortgage of Land and Buildings *contra* ..	10,000	Loose Plant and Tools ..	3,000
Bank Overdraft	15,000	Stock-in-trade	12,000
O. Henry's Capital	32,500	Sundry Debtors	10,500
		Cash in hand	500
	£66,000		£66,000

The purchase price was fixed at £55,000 ; and, in addition, the Esk Vale Company, Ltd., took over the mortgage, and agreed to discharge the liabilities to Sundry Creditors and upon Bills Payable. The purchase price was to be

discharged by the payment of £20,000 in cash and the allotment of £20,000 Ordinary Shares, fully paid, and £15,000 6 % Cumulative Preference Shares, fully paid.

The purchase was completed by the payment of the cash and the allotment of the shares on February 2, 19...

Make the necessary Journal entries (in the books of the Esk Vale Lumber Company, Ltd.) for recording the above transactions. (*Chartered Accountants.*)

17. The Wire Rope Company, Ltd., was formed to acquire the business of Galt & Co., whose Balance Sheet at the date of purchase was agreed as follows :—

LIABILITIES.	£	ASSETS.	£
Creditors	2,500	Cash in hand	175
Capital	13,000	Cash at Bank	825
		Debtors	3,100
		Stock-in-trade	5,000
		Fixtures, etc.	500
		Machinery	3,900
		Leasehold Premises	2,000
	£15,500		£15,500

The agreement entered into provided that the purchase price should be £18,000, payable as to £12,000 in cash, and as to £6,000 by the allotment of 6,000 fully paid shares of £1 each in the Company. The Nominal Capital of the Company was £30,000, of which 20,000 shares of £1 each were allotted on July 1, 19.., payable as to 10s. on application and 10s. on allotment. The whole of the cash due in respect of the shares was duly received. The cash consideration was paid by the Company July 20th, and the vendor's shares were allotted on that date. The preliminary expenses amounted to £400.

Open the books of the Company, recording the above transactions, and prepare a Balance Sheet as at July 20th. (*Incorporated Accountants.*)

18. The Atalanta Insurance Company (having on June 30, 19.., a called-up Capital of £250,000 in £10 shares, £1 paid, quoted on the market at £22 10s., and a Reserve Fund of £1,500,000) purchases, on November 30, 19.., the business of the X.Y.Z. Insurance Company (having on June 30, 19.., a called-up Capital of £200,000 in £20 shares, £2 paid, quoted on the market at £8 10s., and a Reserve Fund of £600,000) for £45 for each five shares, giving one-half of the consideration in its shares taken of the value of £22 10s. each, and one-half in 4 % Debenture Stock taken at par. In addition, 7s. a share in cash is to be given by way of dividend to December 31, 19...

Show how the accounts of the Atalanta Company will stand after the purchase has been completed. (*Chartered Accountants.*)

19. The A Company, Ltd., in 19.. sold one department of its business to the B Company, Ltd. The value of this branch, according to the books of the Company, was £20,000. The purchase price was fixed at £30,000, to be discharged by the issue to the A Company, Ltd., of 30,000 Ordinary Shares of £1 each, fully paid, in the B Company, Ltd.

The A Company, Ltd., had borrowed from S. Antony £20,000 at 6 %, and the B Company, Ltd., being very prosperous, Antony, in 19.., agreed to accept 10,000 B Company shares at £2 per share in discharge of the loan. These shares were accordingly transferred to Antony on June 30, 19...

Draft the Journal entries necessary to record the above transactions in the books of the A Company, Ltd. How would you deal with the apparent

profit on the sale to the B Company, Ltd., and on the transfer of the B shares to Antony? (*Chartered Accountants.*)

20. A limited company is formed to buy a property from B for £50,000; £25,000 in cash and £25,000 in shares. The Capital is £75,000 in 75,000 shares of £1 each. 55,000 shares are issued, 5s. payable on application, 5s. on allotment, 5s. on first call, and 5s. on final call.

The purchase money, £25,000, is paid, and the consideration shares are allotted to B.

The preliminary expenses, £2,200, are paid by the company. Shareholders holding 820 shares fail to pay the final call, and the shares are forfeited under the Articles of Association.

State the Cash Book, Journal and Ledger entries necessary to record the facts. (*Incorporated Accountants.*)

21. The Simplex Engineering Company, Ltd., purchased certain patents from C. Bantock, under an agreement dated June 30, 19.., at a cost of £40,000. £1,000 of this sum was to be paid to the vendors in cash, and the balance in fully paid £10 Ordinary Shares.

Including the shares allotted as fully paid to the vendors, the Company issued Capital to the extent of £75,000, consisting of £50,000 in Ordinary Shares of £10 each (£1 on application, £4 on allotment, and £5 at the end of three months), and £25,000 in 5 % Preference shares of £5 each (£1 on application, £2 on allotment, and £2 at the end of three months).

Under the agreement with Bantock, the patents passed to the Company on July 9, 19.., which date was also the date of allotment.

All the shares issued to the public were fully subscribed and duly paid for with the exception of £200 calls in arrear on the Preference Shares. All cash was paid direct to the Company's Bankers.

Make the necessary entries in the books of the company to give effect to the above transactions, and show how they would appear in the Company's first Balance Sheet. (*London Chamber Commerce.*)

22. On December 31, 19.., the Spen Main Colliery Company, Ltd., had Ordinary Share Capital, authorised and fully subscribed, of £200,000, in shares of £10 each, and a General Reserve of £150,000. During 19.. the Capital was increased by £100,000, in new shares of £1 each; and the original shares were converted into shares of £1 each. Resolutions were duly passed, whereby £100,000 of the Reserve was distributed to the ordinary shareholders as bonus, and was applied in satisfaction of new shares issued to the shareholders at par. Set out the Journal entries and the accounts in full recording the foregoing transactions, and the information, in respect thereof, which should appear on the Balance Sheet of the Company as on December 31, 19... (*Chartered Accountants.*)

23. The following particulars have been extracted from the Balance Sheet of Soleil d'Or, Ltd., as on December 31, 19.. :—

CAPITAL.

	£	£
Nominal: 10,000 5 % Preference Shares of £5 each	50,000	
100,000 Ordinary Shares of £1 each	100,000	
	£150,000	
Issued: 5,000 5 % Preference Shares of £5 each	25,000	
50,000 Ordinary Shares of £1 each	50,000	
		75,000
Reserve Fund		20,000
Profit and Loss Account (Balance)		12,000

During the year 19.. resolutions were duly passed as follows .—

(1) A resolution converting the Preference Shares into Preference Shares of £1 each.

(2) A resolution declaring a bonus of 20 % on the Ordinary Shares, to be provided as to £6,000 out of the Reserve Fund, and as to the remainder out of the balance of Profit and Loss Account. The bonus to be satisfied by the issue of one fully paid Ordinary Share for every five Ordinary Shares held.

Give the Journal entries which are necessary to carry out the above resolutions, and show how they would affect the Balance Sheet of the Company as on December 31, 19... Assume that the profit for the year 19.. amounted to £4,000. (*London Chamber Commerce.*)

24. The Camborne Company, Ltd., with an authorised capital of £50,000, undertook on June 1, 19.., to buy the "Bude" and "Garth" tin mining claims from the Dutchy Company, Ltd., for £10,000, payable as to £1,000 in cash, as to £4,000 in fully paid Ordinary Shares, taken at par, and as to £5,000 in 6 % First Mortgage Debentures.

On June 7, 19.., the Company offered for subscription 40,000 £1 Ordinary Shares at a premium of 2s. per share, payable 5s. per share (including 2s. premium) on application, 5s. per share on allotment, and the balance of 12s. per share on July 15, 19...

Applications were received for 35,950 shares, all of which were allotted on June 10, 19... All allotment moneys were duly paid on June 14, 19...

The purchase agreement was carried out on June 10, 19.., the requisite allotments of shares and debentures and the payment of cash then being made.

All shareholders, except one holding 100 shares, duly paid the calls due on July 15th.

The shares belonging to the defaulting member were declared to be forfeited by the Board on July 31st, and were reissued by the Board on August 7th to James Alexander, on his paying in cash the 12s. per share left unpaid by the original allottee.

Pass these transactions through the Company's books of account, and prepare a Balance Sheet at their conclusion. (*London Chamber Commerce.*)

25. On December 31, 19.., the Balance Sheet of Ravary's, Ltd., was as follows :—

Liabilities.	£	Assets.	£
Nominal Capital, £20,000, divided into 10,000 6 % Cumulative Preference Shares of £1 each, and 10,000 Ordinary Shares of £1 each.		Land and Buildings	2,000
		Plant and Machinery ..	5,000
		Tools and Utensils	1,000
		Stock	7,000
		Sundry Debtors	3,000
		Bills Receivable	900
Paid-up Capital—		Cash	100
6,000 Ordinary Shares	6,000	Profit and Loss Account—	
6,000 Preference Shares	6,000	Dr. Balance	8,000
	12,000		
5 % Debentures	3,000		
Sundry Creditors ..	5,000		
Bills Payable	3,000		
Bank Overdraft	4,000		
	£27,000		£27,000

It was decided to reconstruct the Company, and for this purpose Ravary's (19..) Ltd., was registered with a Capital of £20,000, divided into 8,000

Ordinary Shares of £1 each, and 12,000 7 % Preference Shares of £1 each, to take over the assets and liabilities of the old company.

The Debenture holders of Ravary's, Ltd., agreed to accept 7 % Cumulative Preference Shares in Ravary's (19..), Ltd., in exchange for their Debentures.

The Preference shareholders in Ravary's, Ltd., were to receive one Preference Share in Ravary's (19..), Ltd., for every three shares held by them in the old company.

The Ordinary shareholders were to be allotted one Ordinary Share, 15s. paid, in Ravary's (19..), Ltd., in exchange for every four shares held by them in the old company.

The costs of the liquidation of Ravary's, Ltd., were paid by the new company.

Give the Journal entries necessary to record the above transactions in the books of Ravary's, Ltd. (*Chartered Accountants.*)

26. Two companies, O and P, amalgamate and form a new company, Q. The position of the two companies was as follows :—

O Company.

	£		£
Capital paid up	30,000	Debtors	18,000
Debentures	5,000	Stock	20,000
Creditors	5,000	Goodwill	5,000
Profit and Loss Account ..	3,000		
	£43,000		£43,000

P Company.

	£		£
Capital paid up	20,000	Debtors	20,000
Creditors	8,000	Stock	10,000
Profit and Loss Account ..	2,000		
	£30,000		£30,000

The average profits of the O and P Companies have been £3,000 and £2,000 respectively. The new Q Company agrees with the O and P Companies to take over both concerns for the sum of £60,000, and, in addition, to discharge all liabilities ; £10,000 to be paid in cash, and the balance in shares.

The profit on the conversion is to be divided between the shareholders of the O and P Companies in the same proportion as the profits previously earned by the Companies.

Draw up a Purchase Account on the completion of the Q Company, and show how the Share Capital Accounts in the O and P Companies should be closed.

C. Cox held 5,000 £ shares in O Company and 4,000 £ shares in P Company. Show how much cash and how many shares Cox should receive from the new Company. (*Incorporated Accountants.*)

27. X, Y, and Z, each with a separate business, agree to amalgamate and carry on as a private limited liability company with a nominal Capital of £40,000 ; each taking, as payment for his Capital, fully paid-up shares in the company, and the assets and liabilities being taken over as they stand in the books of the several businesses.

X's assets and liabilities were : Stock, £3,000 ; Book Debts, £5,350 ; Bills Receivable, £1,582 ; Balance at Bank, £895 ; Sundry Creditors, £3,000 ; Bills Payable, £2,000.

Y's assets and liabilities were: Stock, £4,290; Book Debts, £9,250; Bills Receivable, £1,580; Balance at Bank, £1,290; Sundry Creditors, £8,395.

Z's assets and liabilities were: Stock, £8,000; Book Debts, £18,950; Bills Receivable, £3,860; Balance at Bank, £2,350; Sundry Creditors, £15,382; Bills Payable, £5,852; Reserve Fund, £5,000.

Prepare the initial Balance Sheet of the Company. The preliminary expenses of formation, amounting to £250, were paid. (*Chartered Accountants.*)

28. When auditing the books of a limited company, you find the understated Journal entry :—

	£	£
Loan Account, Dr.	10,000	
To London and Loamshire Bank		10,000
For loan secured by the issue of £12,000 of the 5 % Debentures of the company.		

Explain the meaning of this entry, and state how the transaction should appear in the published Balance Sheet of the company. (*Chartered Accountants.*)

29. The following are Balance Sheets of two Companies, M and N, on June 30, 19.. :—

Company M.	£	£
Share Capital, fully paid	149,500	
Forfeited Shares Account	125	
Debentures	40,000	
Plant and Machinery		37,500
Freehold Property		43,000
Bank Account		2,000
Goodwill		40,000
Sundry Creditors	5,875	
Sundry Debtors		25,000
Stock		68,000
Profit and Loss Account	20,000	
	£215,500	£215,500

Company N.	£	£
Share Capital	40,000	
Debentures	3,000	
Calls in arrear		500
Plant and Machinery		2,500
Freehold Property		2,000
Debtors and Creditors	25,000	22,500
Stock		18,000
Profit and Loss Account		16,500
Goodwill		6,000
	£68,000	£68,000

Company M decides to take over Company N, and agrees to discharge the liabilities and debentures and take over all the assets, the consideration being £1,200 cash and £30,000 shares in Company M, issued as fully paid up. The calls in arrear are worthless, and the shares were forfeited by the Directors of Company M prior to amalgamation. Company N is to pay its own costs of liquidation.

Draw up a Balance Sheet of the M N Company. (*Incorporated Accountants.*

30. The following are the Balance Sheets on December 31, 19.., of the Fas and Nefas Companies respectively :—

FAS COMPANY, LTD.

LIABILITIES.	£	ASSETS.	£
Capital, 100,000 shares, £1 each, fully paid	100,000	Freehold Premises	22,500
Sundry Creditors	18,129	Machinery and Plant ..	32,659
Reserve	7,000	Sundry Debtors	24,682
Profit and Loss, balance ..	16,440	Stock	38,640
		Cash in Bank and in hand ..	23,088
	£141,569		£141,569

NEFAS COMPANY, LTD.

LIABILITIES.	£	ASSETS.	£
Capital, 6,000 shares, £5 each, fully paid	30,000	Machinery and Plant, cost	22,240
Sundry Creditors	10,270	Sundry Debtors	6,249
		Stock	9,423
		Cash	129
		Profit and loss, balance ..	2,229
	£40,270		£40,270

It is agreed that the Fas Company shall purchase the Nefas Company as on December 31, 19.., on the following basis :—

(1) A dividend of 15 % to the shareholders of the Fas Company, to be declared prior to the amalgamation.

(2) The Fas Company to take over the assets of the Nefas Company, the consideration being : (*a*) The payment of the liabilities of the Nefas Company ; (*b*) the payment of the costs of amalgamation ; (*c*) the issue to the shareholders of the Nefas Company of seven fully paid shares of £1 each in the Fas Company for every two fully paid shares in the Nefas Company.

The costs of amalgamation amounted to £1,206. The floating assets of the Nefas Company were worth the values stated on the Balance Sheet. Draft the Journal entries recording the purchase in the books of the Fas Company, and set out the Balance Sheet of the Company after the amalgamation. (*Chartered Accountants.*)

31. Two companies carrying on similar businesses decide to amalgamate as on and from January 1, 19...

Their respective agreed Balance Sheets at December 31st previous were as follows :—

X COMPANY, LTD.

LIABILITIES.	£	ASSETS.	£
7,500 Ordinary Shares, £10 each	75,000	Freehold Land and Buildings	12,000
Sundry Creditors	4,000	Plant and Machinery (less depreciation)..	19,500
Reserve Fund	5,000	Stock	15,000
Profit and Loss Account ..	2,000	Sundry Debtors	8,000
		Cash in hand and at Bank ..	1,500
		Goodwill	30,000
	£86,000		£86,000

Y Company, Ltd.

Liabilities.	£	Assets.	£
5,000 Ordinary Shares of £10 each	50,000	Plant and Machinery ..	25,000
Sundry Creditors	3,500	Stock	12,000
Depreciation Fund	2,500	Sundry Debtors	6,000
Profit and Loss Account ..	2,500	Cash in hand and at Bankers	500
		Goodwill	15,000
	£58,500		£58,500

X Company, Ltd., which has been in existence for several years, has regularly depreciated plant and machinery, but Y Company, Ltd., only commenced business on January 1, 19.., and plant and machinery stands at cost, depreciation having been provided for by means of a Depreciation Fund.

It is agreed that the combined Company shall take over the assets (including goodwill) and discharge the liabilities of each Company on the basis of the figures in their respective Balance Sheets.

The Capital of the combined Company was £200,000, divided into 100,000 Ordinary Shares of £1 each, and 100,000 6 % Cumulative Preference Shares of £1 each.

The combined Company issued £15,000 Ordinary Shares at par for cash, and agreed to allot to each shareholder in the X and Y Companies five Ordinary and five Preference Shares of £1 each, fully paid, in exchange for each £10 share held by them, and to discharge any balance in cash.

Draw up the Balance Sheet of the combined Company, after the above transactions have been completed, and show what each shareholder in the Z and Y Companies would receive in shares in the new Company and in cash. (*Chartered Accountants.*)

32. Two private companies, the A Company, Ltd., and B Company, Ltd., amalgamate in the following manner :—

A holding company, called the C Company, Ltd., was registered on July 1, 19.., with a Capital of £200,000 in £1 shares, to purchase all the Ordinary Shares of both Companies. X, the Managing Director of the A Company, Ltd., and Y, the Managing Director of the B Company, Ltd., each took up and paid for 1,000 shares.

The Issued Capital of the A Company, Ltd., consisted of 75,000 Ordinary Shares of £1 each, fully paid, and 60,000 6 % Cumulative Preference Shares of £1 each, fully paid. The Issued Capital of the B Company, Ltd., consisted of 40,000 Ordinary Shares of £1 each, fully paid.

The A Company, Ltd., shareholders received one £1 share fully paid in the C Company, Ltd., in exchange for each of their Ordinary Shares. The B Company, Ltd., shareholders received one and a half £1 shares, fully paid, in the C Company, Ltd., in exchange for each of their Ordinary Shares.

The formation and preliminary expenses of the C Company, Ltd., amounting to £1,500, were paid out of cash.

Make the necessary entries in the books of the three companies to give effect to the above arrangements, and set out the opening Balance Sheet of the C Company, Ltd. (*Chartered Accountants.*)

33. The X Company agreed to take over the Y Company as a going concern. The X Company was to pay the debentures and liabilities of the Y Company, and take over the assets, the consideration being the issue by the X Company of 40,000 fully paid shares of £1 each, and the payment of £3,000 in cash to the Y Company. The X Company was to pay the liquidation expenses, which amounted to £1,400.

The balances in the books of the respective Companies, as on the date of absorption, are as follows :—

	X Dr.	Y Dr	X Cr.	Y Cr.
	£	£	£	£
Nominal Share Capital :—				
X Company, 200,000 shares of £1 each.				
Y Company, 75,000 shares of £1 each.				
Capital issued			150,000	50,000
Unpaid Calls	500	100		
5 % Debentures			50,000	10,000
Freehold and Leasehold Property	103,330	35,682		
Goodwill	30,000	5,000		
Sundry Creditors			8,342	4,362
Sundry Debtors	7,240	3,984		
Bank Balances	16,842			2,000
Stock	17,926	7,852		
Plant and Machinery	38,768	16,439		
Bills Receivable	3,621			
Profit and Loss Account (Balance)			9,885	2,695
	£218,227	£69,057	£218,227	£69,057

Assume that the absorption was duly effected, but that the unpaid calls and a book debt of £400 due to the Y Company proved irrecoverable.

Prepare the Balance Sheet of the X Company after absorption of the Y Company. (*Chartered Accountants.*)

34. The accounts of the Clifford Trading Co., Ltd., for the financial year ended April 30, 19.., show a net profit of £125,000. The Company has an issued and paid-up capital of £600,000 divided into 400,000 Ordinary Shares of £1 each and 200,000 6 % Preference Shares of £1 each. There was a credit balance of £24,891 13s. 4d. brought forward as Profit and Loss Account from the previous period. The directors decide at March 31, 19.., subject to the approval of the members in General Meeting, to apportion the available profit as follows : (1) Pay the year's dividend on Preference Shares. (2) Write £10,000 off Goodwill. (3) Carry £20,000 to General Reserve Account. (4) Redeem 25 Debentures at £1,000 each at par. (5) Pay a dividend on the Ordinary Shares free of Income Tax up to such an amount as will leave a balance of not less than £20,000 to be carried forward.

Show the effect of this decision of the directors in the form of an Appropriation Account, making a reserve for Income Tax at 4s. in the £. It may be assumed that all items in the Profit and Loss Account have been allowed for Income Tax purposes. (*Central Association Accountants.*)

35. The Profit and Loss Account of Soleil d'Or, Ltd., prior to the payment of debenture interest for the half-year to December 31, 19.., disclosed a profit of £12,850 as on December 31, 19... The Paid-up Capital of the Company consisted of £100,000, divided into 50,000 5 % Preference Shares of £1 each, and 50,000 Ordinary Shares of £1 each. 100 Debentures of £100 each at 4 % had also been issued. The directors made the undermentioned recommendations for the disposal of the above balance which were approved by the shareholders at the annual meeting : (1) To pay the half-year's interest to December 31, 19... due on the Debentures. (2) To pay the

Preference dividend for the half-year to December 31, 19... (3) To pay a dividend for the year ended December 31, 19.., of 10 % on the Ordinary Shares, free of Income Tax. (4) To transfer £5,000 to Reserve, raising that Account to £15,000 in all. (5) To carry forward the balance to next year Show the entries necessary to record these transactions in the books of Soleil d'Or, Ltd. (*London Chamber Commerce.*)

36. The Profit and Loss Account of a limited company showed a credit balance of £53,368 10s. 8d.

The directors of the company decided to dispose of this balance as follows: (1) To transfer £500 to a Forged Transfers Reserve Account and £8,000 to General Reserve Account; raising the latter to £20,000. (2) To pay the half-year's dividend due on the £150,000 6 % Preference Shares. (3) To pay a dividend of 8 % on the £250,000 Ordinary Shares free of tax. (4) To write off the balance of the Debenture Issue Expenses Account which stood at £3,876. (5) To carry forward the balance to next year.

Assume that these proposals were confirmed by the shareholders and give the entries necessary to record them in the books of the company. Assume that Income Tax was 4s. in the £. (*Chartered Institute Secretaries.*)

37. The Newspaper Trust, Ltd., was registered (Nom. Cap. £110,000—50,000 7 % £1 Preference Shares, 50,000 £1 Ordinary Shares and 10,000 £1 Deferred Shares), to purchase an established county newspaper. All the Preference Shares were issued fully called and paid up. All the Ordinary Shares were offered and 45,000 applied for and allotted, 15s. per share was called and paid up, except a call of 5s. per share on 1,000 shares. 2,000 Ordinary Shares were paid up in full. The 10,000 Deferred were issued to the vendors fully paid as the purchase price of the goodwill. On July 1, 19.., 200 6 % £100 Debentures were issued at 95 and fully paid up. Interest due on these debentures as on December 31, 19.., had not been passed through the books. In addition to the Ledger Accounts representing the above transactions, the following Ledger balances were extracted from the books of the Company as on December 31, 19..: Machinery and Plant, £14,800; Monotype Machines, £6,860; Freehold Works and Offices, £51,229; Sales, £22,041; Sales (Cash), £982; Advertisement Receipts, £26,518; Jobbing Printing Receipts, £987; Printers' and Compositors' Wages, £13,221; Office Furniture, £680; Cash at Bank, £8,123; Cash in hand, £421; Sundry Creditors, £224; Sundry Debtors, £8,460; Purchases (Ink and Printing Materials), £6,956; Sales Returns, £989; Management and Office Salaries, £3,578; Office Expenses, £397; Advertisement Canvassers' Salaries and Commission, £1,326; Discount Account (Debit balance), £123; Printing Works Expenses, £1,784; Carriage Outwards, £224; Carriage Inwards, £198; Bad Debts, £188; Bad Debts Reserve (January 1st), £200; Coal and Lighting (Works), £972; Coal and Lighting (Office), £54; Rates, Taxes, Insurance (Works), £424; Rates, Taxes, Insurance (Office), £98; Cost of Literary Contributions, £244; Machinery Repairs, £632; Stock of Type, Plates, etc. (January 1st), £12,965; New Type purchased, £1,284; 1,000 £1 Shares in *Loamshire Evening News* purchased at 15s. per share, £750; Stock of Paper, Ink, etc. (January 1st), £9,872; Motor Vans, £6,500; Directors' Fees, £600.

Prepare Trading and Profit and Loss Accounts for the year ended December 31, 19.., and a Balance Sheet as on that date, taking into account the following: (*a*) Depreciation, Machinery and Plant 10 %, Monotype Machines, 15 %; (*b*) £1,000 is to be reserved in connection with pending action for libel; (*c*) £120 paid to an injured Workman and included in Printers' Wages is recoverable from an Insurance Co.; (*d*) Bad Debts Reserve to be increased to equal 5 % on Sundry Debtors; (*e*) Stock, Paper, Ink, etc., December 31, 19.., was £8,740. On the same date Motor Vans were £5,800 and Type, Plates, etc., £13,000; (*f*) £2,500 of "Advertisement Receipts" represent

unexpired prepaid advertisements, and is to be carried forward to next year; (*g*) the *Loamshire Evening News* went into liquidation and the shares are to be written off; (*h*) One-fifth of the Debenture Discount is to be written off; (*i*) No entries have been made in the books in respect of 12 months' Interest at 5 % due upon the calls made in advance. (*Chartered Institute Secretaries.*)

38. The Rayon d'Or Copper Mining Company was registered on January 1, 19.., with a nominal capital of 100,000 Ordinary Shares of £1 each to work concessions, for which £50,000 was paid. All the Capital was issued and 15s. per share paid up as on December 31, 19... One shareholder had also paid up the balance of 5s. per share on his holding of 1,000 shares. On July 1, 19.., the Company issued 100 8 % Debentures of £100 each at 105, the issue being fully subscribed and paid up. During the year 19.., a deposit of vanadium was found, and the Directors decided to treat all expenditure thereon as capital expenditure pending developments. In addition to the accounts necessary to record these particulars, the following balances were extracted from the Company's books as on December 31, 19..: Buildings, £8,000; Loose Tools, £890; Machinery and Plant, £19,800; Preliminary Expenses, £1,250; Stock of Stores (January 1st), £4,198; Workmen's Wages, £9,872; Workmen's Wages (Vanadium), £1,288; Office Furniture, £800; Carriage and Freight, £4,876; Carriage and Freight (Vanadium), £1,124; Salaries, £2,910; Salaries (Vanadium), £150; Stores purchased, £3,241; Stores purchased (Vanadium), £1,124; Law Costs, £329; Rates, Taxes and Licences, £1,340; Rates, Taxes and Licences (Vanadium), £250; Light Railway Wagons, etc., £10,450; Bills Payable, £981; Bank Overdraft, £5,860; Cash in hand, £984; Sundry Creditors, £4,238; Sundry Debtors, £12,940; Fuel, £3,496; Fuel (Vanadium), £940; Sales of Copper Ore, £46,087; Marine Insurance, £1,298; Office Expenses, £321; Office Expenses (Vanadium), £50; Directors' Fees, £1,000; Transfer Fees, £5.

Prepare a Working Account for the year ended December 31, 19.., and a Balance Sheet as on that date. Before doing so take the following matters into consideration: (*a*) Write off 10 % Depreciation from Machinery and Plant, 5 % from Office Furniture, and £1,000 from Buildings; (*b*) Stores on hand on December 31, 19.., were valued at £3,876, Light Railway Wagons, etc., at £9,000, and Loose Tools at £600; (*c*) Write off 50 % of the preliminary Expenses; (*d*) Create Reserve for Bad Debts equal to 5 % of the Sundry Debtors; (*e*) The Shareholder who paid his call in advance is entitled to 5 % interest thereon for 12 months, but no entries have yet been made; (*f*) Debenture interest due December 31, 1919, has not been passed through the books. (*London Chamber Commerce.*)

39. The Cosmopolitan Hotel Company, Ltd., was formed to purchase an old-established hotel, and was registered with a nominal capital of £110,000, divided into 50,000 Ordinary Shares of £1 each, 50,000 7 % Cumulative Preference Shares of £1 each, and 10,000 Deferred Shares of £1 each. All the Deferred Shares were issued to the Vendors as the purchase price of the Goodwill. The Ordinary Shares were issued at par, and the Preference Shares at a premium of 2s. 6d. per share. Both classes of shares were fully subscribed and paid up, except that the final call of 5s. per share upon 1,000 Preference Shares remained unpaid as on December 31, 19... On July 1, 19.., 200 6 % Debentures of £100 each, repayable at par in 10 years, were issued at 95, fully subscribed and paid up. In addition to the accounts represented by the foregoing, the following ledger balances were extracted from the Company's books, as on December 31, 19..:—Freehold Hotel, £134,400; Furniture and Fittings, £22,800; Preliminary Expenses Account, £800; *Purchases:* Provisions, £38,726; Wines, Beer and Spirits, £22,462; Sundries, £624; Wages of Waiters and Staff, £8,986; Office Salaries, £827; Hotel Takings, £99,861; Laundry Expenses, £1,794; Bar Takings, £12,842; Billiards Takings, £416; Carriage Inwards, £347; Laundry Receipts, £1,912;

Sundry Working Expenses, £1,296; Coal and Lighting, £842; Repairs to Furniture, etc., £2,441; Motor Omnibuses, £2,400; Advertising, £1,575; Discount Account (Credit Balance), £342; Omnibus Receipts, £1,284; Transfer Fees, £5; Stock (January 1st), £5,986; Profit and Loss Account, January 1, 19.. (Credit Balance), £13,842; Sundry Creditors, £1,869; Sundry Debtors, £798; Directors' Fees, £500; Cash at Bank, £4,864; Cash in Hand, £897; Preference Share Dividend for half-year to June 30, 19.., £1,750; Rates, Taxes and Insurance, £2,162; Bad Debts, £96.

Prepare Trading and Profit and Loss Accounts for the year ending December 31, 19.., and Balance Sheet as on that date. Before preparing the Accounts make the following adjustments: (*a*) The Debenture Interest due on December 31, 19.., had not been passed through the books. (*b*) As on December 31 19.., the following amounts were outstanding and had not been provided for: Wages £126, Salaries £52, Excess Profits Duty £2,461. (*c*) Insurance paid in advance amounted to £148 as on December 31, 19... (*d*) Depreciate Furniture and Fittings, 15 % and Motor Omnibuses, 20 %. (*e*) The Stock of Wines, Spirits and Provisions on hand as on December 31, 19.., was valued at £7,221. (*f*) Write £200 off Debenture Discount Account, and £400 off Preliminary Expenses Account. (*g*) Carry £7,500 to a Reserve Account. (*Royal Society Arts.*)

40. The Rugosa Manufacturing Company, Ltd., was registered with a nominal capital of 50,000 shares of £1 each, of which 40,000 shares had been issued and fully called.

The following Trial Balance was extracted as on December 31st:—

	£	£
Stock (January 1st)	18,642	
Manufacturing Wages	10,974	
Coal and Coke	1,924	
Purchases and Sales	82,146	116,990
Machinery Repairs	861	
Carriage Inwards	491	
Carriage Outwards	964	
Interim Dividend (July 1st)	2,000	
Income Tax	1,429	
Bank Loan (5 %)		5,000
Interest on Loan	125	
Sundry Debtors and Creditors	16,440	9,222
Profit and Loss Account (Balance from last year)		3,864
Bank Current Account	1,686	
Cash in hand	192	
Leasehold Factory	6,421	
Machinery and Plant	7,840	
Loose Tools	1,250	
Share Capital		40,000
Calls in arrear	100	
Rent, Rates, and Light (Factory, £1,421; Offices, £340)	1,761	
Directors' Fees	1,200	
Office Salaries and Expenses	1,425	
Office Furniture	500	
Commission	864	
Returns	1,264	981
Preliminary Expenses Account	600	
Transfer Fees		42
Goodwill	15,000	
	£176,099	£176,099

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended December 31st, and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into consideration: (1) Write one-third off the Preliminary Expenses Account. (2) Write 10 % depreciation off Machinery and Plant, and 5 % off Office Furniture. (3) Manufacturing Wages £189, and Office Salaries £120, had accrued due as on December 31st, but no entries had been made in the books. (4) Provide for the interest due on the Bank Loan for the half-year ended December 31st. (5) The Stock was valued at £12,484, and Loose Tools at £1,000, as on December 31st. (6) Reserve £850 on the Sundry Debtors for bad and doubtful debts. (7) Reserve 2½ % on the Sundry Debtors for discount. (*Royal Society Arts.*)

41. The Windyridge Horticultural Company, Ltd., was registered with a nominal capital of 30,000 shares of £1 each, of which 12,500 shares had been issued and fully called up.

The following Trial Balance was extracted from the books of the Company as on December 31st :—

TRIAL BALANCE.

	£	£
Share Capital Account		12,500
Goodwill	5,000	
Leasehold Warehouse and Offices	5,547	
Loose Tools	700	
Workmen's Wages	2,586	
Rent and Rates (Warehouse, £750 ; Offices, £120)	870	
Purchases	9,642	
Sales		17,894
Receipts for Constructing Gardens		1,963
Stock (January 1st)	3,861	
Purchases Returns		94
Sales Returns	39	
Carriage Inwards	127	
Carriage Outwards	98	
Insurance (Warehouse, £92 ; Offices, £26)	118	
Office Salaries	697	
Directors' Fees	450	
Discount Account		37
Motor Lorry	1,200	
Office Furniture	320	
Loan on Mortgage, at 10 %		2,000
Interest Account and Bank Charges	136	
Calls in arrear	250	
Sundry Debtors	3,742	
Sundry Creditors		2,520
Heating and Lighting (Warehouse, £72 ; Office, £35)	107	
Advertising	975	
Bank Overdraft		462
Cash in hand	107	
Reserve for Bad Debts (December 31, 1920)		300
Profit and Loss Account (Balance from last year)	1,198	
	£37,770	£37,770

You are required to prepare Trading and Profit and Loss Accounts for the year ended December 31st, and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into consideration: (*a*) Office Salaries, £32, had accrued due as on December 31st, but had not been passed through the books. (*b*) Insurance (Warehouse), £12, had been paid in advance. (*c*) Interest for the half-year to December 31st on the Mortgage had accrued due, but had not been passed through the books (ignore Income Tax). (*d*) The following depreciation is to be provided: Motor Lorry, 15 %; Loose Tools, 25 %; Office Furniture, 5 %. (*e*) The Reserve for Bad Debts is to be increased to £400. (*f*) The Stock on hand as on December 31st was valued at £4,062. (*Royal Society Arts.*)

42. The Pernet Manufacturing Company, Ltd., was registered in 19.. with a nominal capital of £200,000, divided into 150,000 Ordinary Shares of £1 each and 10,000 6 % Preference Shares of £5 each. Of this Capital, 65,000 Ordinary Shares had been subscribed for and allotted to the public, and 20s. per share called up. The whole of the Preference Shares had been issued and fully called and paid up.

On January 1, 19.., the Company took over the assets and liabilities of Lamia, Limited, at their book values, which were as follows: Sundry Debtors, £16,136; Sundry Creditors, £3,862; Stock, £14,850; Machinery and Plant, £10,890; Cash, £1,986.

The purchase price was agreed at £50,000, and was satisfied by the issue of 50,000 Ordinary Shares in the Pernet Company issued to the Lamia Company as fully paid.

On July 1, 19.., 200 5 % Debentures of £100 each were issued at 95.

In addition to the records arising out of the above particulars, the following balances were extracted from the books of the Company as on December 31, 19..:—

Machinery and Plant, £32,765; Machinery and Plant, Additions during the year, £8,456; Leasehold Works, £77,841; Manufacturing Wages, £86,968; Profit and Loss Account (Debit Balance from last year), £7,862; Sinking Fund for Leasehold Redemption, £8,850; Sundry Debtors, £12,460; Sundry Creditors, £35,503; Stock (January 1st), £32,641; Factory Power and Light, £3,642; General Expenses, £4,785; Purchases, £76,495; Uncompleted Contracts (January 1st), £13,844; Unpaid Calls (Ordinary Shares), £500; Returns Inwards, £864; Returns Outwards, £3,241; Loose Tools, £2,864; Machinery and Plant sold during the year, £5,641; Management Salaries, £3,522; Machinery Repairs, £1,267; Office Salaries, £3,842; Directors' Fees, £750; Office Furniture, £684; Discount Account (Debit Balance), £174; Reserve for Bad Debts (January 1st), £500; Travellers' Salaries and Commission, £6,894; Carriage on Purchases, £3,641; Carriage on Sales, £4,846; Transfer Fees, £146; Sales, £169,159; Cash at Bank, £3,246; Cash in hand, £1,187; Loan from Bank, £15,000; Patents, £20,000.

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended December 31, 19.., and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into consideration: (*a*) No provision has been made for the Debenture Interest due on December 31st. (*b*) As on December 31st, the following items were due but not recorded in the books: Wages, £996; Office Salaries, £226; and Directors' Fees, £750. (*c*) Manufacturing Wages, £541, were paid to workmen employed in making Loose Tools for the Company's use, but the requisite transfer had not been made. (*d*) The Manufacturing Account is to be charged with two-thirds of General Expenses and Management Salaries. (*e*) Reserve £500 for fine under an uncompleted contract now subject to litigation. (*f*) The following valuations were made as on December 31st:

Machinery and Plant, £32,640; Loose Tools, £2,951; Office Furniture, £600; Stock, £28,740; and Uncompleted Contracts, £9,641. (*g*) Reserve $2\frac{1}{2}$% for Travellers' Commission outstanding on December Sales, which were £13,960. (*h*) The Bad Debt Reserve is to be made equal to 5% on the Sundry Debtors. (*London Chamber Commerce.*)

43. The Ramshackle Motor Co., Ltd., acquired the undertaking of Messrs. Smith Bros., Ltd., as at the end of 19... The following Statement of Accounts, made up to June 30th following, is submitted to you for audit. Criticise the statement, taking at least six points (three on the Balance Sheet and three on the Trading and Profit and Loss Account).

BALANCE SHEET.

DR.		£		CR. £
To Capital		250,000	By Freehold and Buildings	87,650
,, £30,000 5% Mortgage Debentures issued at 10% Discount		27,000	,, Goodwill, Patents, Patterns, Plant, and Work in progress	74,342
,, Creditors—			,, Fixtures and Fittings (Office)	232
On Open Account	£16,444		,, Investments	4,732
Debenture Interest	1,500		,, Cash at Bank and in hand	12,411
		17,944	,, Capital unissued	25,770
,, Reserve for Bad Debts		279	,, Debtors	2,075
			,, Stock	84,784
			,, Suspense Account	3,227
		£295,223		£295,223

TRADING AND PROFIT AND LOSS ACCOUNT.

DR.	£		CR. £
To Stock acquired from Vendors	21,441	By Sales	10,418
,, Purchases	58,937	,, Amounts paid on forfeited shares	385
,, Wages	4,392	,, Appreciation in value of Securities	219
,, Rates and Taxes	1,174	,, Stock, June 30, 19..	84,784
,, Debenture Interest	1,500	,, Balance carried to Suspense Account	392
,, Fuel and Lighting	1,052		
,, Cartage	589		
,, Office Expenses	3,441		
,, Bad and Doubtful Debts	279		
,, Preliminary Expenses	2,143		
,, Directors' Fees	1,250		
	£96,198		£96,198

(*Chartered Accountants.*)

44. G. Emblem is a motor-car and cycle dealer. He divides his business into two departments, viz. Motors ("M") and Cycles ("C").

On March 31, 19.., the following balances were extracted from Emblem's books:—

Stock at beginning of year ("M," £12,812; "C," £3,210), £16,022; Purchases ("M," £22,714; "C," £9,222), £31,936; Workshop Wages ("M," £3,218; "C," £924), £4,142; Workshop Rent and Rates ("M," £850; "C," £250), £1,100; Workshop Power, Light, and Heating ("M," £621; "C," £182), £803; Travellers' Salaries and Commission, £4,683; Office and Showroom Salaries, £3,846; Office and Showroom Expenses, £1,242; Workshop Expenses ("M," £1,262; "C," £341), £1,603; Capital Account (March 31, 1923), £30,000; Leasehold Workshop and Offices, £3,264; Additions to Workshop during the year, £1,862; Machinery and

Plant, £5,740; Loose Tools (March 31, 19..), £1,282; Bad Debts Reserve (March 31, 19..), £678; Discount Account (Credit Balance), £372; Income Tax and Excess Profits Duty, £2,841; Sundry Debtors, £9,780; Sundry Creditors, £14,941; Sales ("M," £33,892; "C," £12,225), £46,117; Purchases Returns ("M," £1,281; "C," £191), £1,472; Sales Returns ("M," £842; "C," £47), £889; Apprentices' Fees ("M," £400; "C," £100), £500; Insurance, Workshop ("M," £1,842; "C," £421), £2,263; Motor Lorries, £1,880; Interest and Bank Charges, £873; Office Furniture, £560; Carriage Inwards ("M," £1,082; "C," £296), £1,378; Distribution and Advertising Expenses, £5,895; Office and Showroom Rent and Rates, £585; Bills Payable, £1,526; Drawings Account (G. Emblem), £1,000; Cash in hand, £137; Bank Loan, £10,000.

You are required to prepare Trading and Profit and Loss Accounts for the year ended March 31, 19.., and a Balance Sheet as on that date. The Trading and Profit and Loss Accounts are to be prepared in columnar form, showing the results of the year's working in each department. The Profit and Loss items are to be apportioned as to two-thirds to "M" department and one-third to "C" department.

When preparing these accounts, the following matters must be taken into consideration:—(*a*) On March 31, 1924, the following valuations were made: Stock, "M," £10,726; "C," £2,010; Motor Lorries, £1,700; Loose Tools, £1,000. (*b*) The following depreciations are to be provided for: Machinery and Plant, 15 %; Office Furniture, 10 %; Workmen's Wages ("M" department), £121, had been paid for time in making loose tools, and wages, £46 ("C" department), had been paid to an injured workman on behalf of an Employers' Liability Insurance Company, by whom it was still owing. (*c*) Insurance was paid in advance as follows: "M" department, £181; "C" department, £56. (*d*) £100 Apprentices' Fees ("M" department) is to be carried to next year as fees received in advance. (*e*) Interest on capital at 5 % is to be charged, but no interest is to be charged on drawings. (*f*) An amount equal to 5 % on the Sundry Debtors is to be provided for bad and doubtful debts. (*Royal Society Arts.*)

45. The following Balance Sheet was issued by the Eldorado Plantations, Ltd.:—

BALANCE SHEET, DECEMBER 31, 19...

Dr.	£	£
Issued Share Capital	190,000	
Less Calls in arrear	8,000	
		182,000
Bank Loan		48,000
Sundry Creditors		3,647
Bills Payable		32,100
Profit and Loss Account—		
Profit for the year	9,120	
Less Interim Dividend paid	9,100	
		20
Depreciation Fund		5,000
		£270,767

		Cr. £
Leasehold Land, Buildings and Machinery at cost		200,000
Railway, Wharf, Motor Boats, Live Stock, etc., at cost	£12,000	
Less Depreciation	500	
		11,500
Expenditure on 19.. Crop to date		48,400
Expenditure on 19.. Crop to date		685
Advances to Coolies and Sundry Debtors		6,850
Exchange Suspense Account		392
Cash on Plantation		1,850
Cash at Bankers in London		1,090
		£270,767

You are asked to criticise this Balance Sheet from the point of view of a prospective shareholder. If you desire any further information before giving your opinion, submit the letter which you would address to the secretary of the company. (*Chartered Institute Secretaries.*)

46. Define: "Contingent Liability," "Collateral Security," and state how you would treat them in the Final Accounts of a firm? (*Incorporated Accountants.*)

47. Briefly explain the information contained in the undermentioned registers as employed by limited companies: Register of Mortgages and Charges; Register of Transfers; Register of Probates and Administrations; Register of Balance Certificates.

Submit the ruling of *one only* of these registers, and make a specimen entry therein. (*Royal Society Arts.*)

CHAPTER XIII

THE DOUBLE-ACCOUNT SYSTEM

THE term " Double-Account " does not indicate a particular system of book-keeping, but a particular method of presenting the final accounts of such undertakings as elect, or are bound by Statute, to adopt that method. Certain undertakings of public utility and of a permanent kind (e.g. Railways, Gas Works, etc.) are bound by the Legislature to present their accounts in this form. There is no connection whatever between the terms " double-entry " and " double-account," or between the terms " single-entry " and " single-account."

Two Systems Contrasted.—Both " single- " and " double-account " systems are based upon double-entry book-keeping, and in both cases the detailed book-keeping is the same. The sole distinction between the two lies in the form in which the final accounts are presented.

Under the single-account system, all assets and liabilities are marshalled in a single statement or balance sheet. A basic principle of this balance sheet is that capital wastage should be recognised and provided for therein.

Under the double-account system, the Balance Sheet is prepared in two sections. The first section (*Receipts and Expenditure on Capital Account*) deals, on the credit side, with the cash raised by the issue of shares, debentures, loans, and the premiums (if any) on such issues. The discounts, if any, on capital issues are also shown in this section. The debit side of this section details the expenditure upon the fixed assets of the undertaking of the capital monies thus raised.

The statutory form of the account makes no provision for wastage of the fixed assets in this section, but it is inexact to aver, as some students do, that no provision for waste is or can be made, as will be demonstrated later.

It will be noted that the assets and liabilities appear on the reverse sides from those ordinarily adopted for commercial accounts.

The balance * of this first section, representing the amount of the unexpended capital, or the extent to which debt has been incurred, or the floating assets have been encroached upon, is carried to the second section (*General Balance Sheet*). In this section, the floating assets, liabilities, and reserves of the undertaking are scheduled.

* In electrical undertakings, the *total* debits and credits are carried forward.

Origin and Application.—The double-account system is of statutory origin, and was first prescribed by the *Regulation of Railways Act*, 1868, since amended by the *Railway (Accounts and Returns) Act*, 1911,* the first schedule to which prescribes the form of accounts to be employed. The system has been extended to Gas Companies by the *Gas Works Clauses Act*, 1871, and to Electricity undertakings by the *Electric Lighting Acts*, 1882–1909. Water companies usually adopt the system, although they are under no compulsion to do so.

Apparent Object of the System.—S. 65 of the *Companies Clauses Consolidation Act*, 1845 (the parent Act dealing with parliamentary companies), enacts that "all the money raised by the company . . . shall be applied . . . in carrying the purposes of the company into execution." The purposes of the company were usually of a monopolistic kind, and the clause quoted appears to have suggested to the Legislature that the public, who subscribed the money for the specific purpose sanctioned by Parliament, were entitled to be assured that the money so subscribed had actually been expended for that specific purpose. Hence the first section of the Balance Sheet, which, in its inception at any rate, is designed to be practically a cash statement, in which the *present value* of the fixed assets is ignored. A new system of presenting accounts was thus inaugurated. This system has been rejected by other nations, and, in the writer's opinion, we also could very well dispense with it.

Double-Account Fallacies.—Whatever the drawbacks of the system may be, they are not so detrimental as many examination candidates would appear to suppose. Supported by some text-books, the examinee is apt to declare flatly that once an asset appears in the accounts there it must for ever remain at cost price, no provision for wastage being permitted. Many candidates venture further, and state that the profits shown are inaccurate, owing to the fact that no provision for depreciation is made. Both these statements are inaccurate.

Dealing with the first criticism, let us assume, by way of illustration, that a railway company purchased a motor-lorry for £1,000, which, at the end of its useful life of, say, five years, the company does not propose to replace. The accounting procedure would be as follows: "Receipts and Expenditure on Capital Account" would be debited with £1,000 upon the purchase of the lorry; one-fifth of this cost, £200, would be debited against revenue through No. 8 statement, "Revenue Receipts and Expenditure of the Whole Undertaking," and credited to a special Depreciation Account raised for the purpose. At the end of the five years, when the reserve for depreciation equalled the original capital cost (i.e. £1,000), the Depreciation Account would be closed by transfer to the Capital Expenditure Account, and a credit of £1,000, *printed in italics*, would appear in

* As modified by the order of the Minister of Transport, dated 27th December, 1928.

"Receipts and Expenditure on Capital Account," thus eliminating the asset. This illustration demonstrates one method only of the several employed by railway companies to provide for the elimination of wasting assets. Reference to the "Receipts and Expenditure on Capital Account," reproduced on pp 542-3, will reveal several credit entries recording amounts written back to revenue (e.g. "Land, Property, etc., not used in Connection with Railway Working, £19,783 0s. 8d."), representing the net balance of land and property sold, etc.

As to the second criticism above, it may appear, at first sight, that the statutory form of Balance Sheet inhibits the provision for waste. It is true that provisions of this kind cannot be made by the direct methods employed under the single-account system, but the statutory double-account form of accounts sanctions such provisions in some cases and enforces them in others; and reference to the Balance Sheet reproduced on p. 548 will demonstrate that it is the practice of British railway companies to accumulate out of revenue large reserves to provide for obsolescence, depreciation and other purposes. In the case of Gas and Electrical companies, such reserves are specifically provided for.

An example of the elimination of assets that have been abandoned or "scrapped" may be afforded by describing the methods employed when an old station is replaced by an entirely new one. As this particular illustration has on several occasions elsewhere been incorrectly employed, it will be advantageous to employ it again and to describe the actual procedure adopted.

Illustration.—Loamtown station originally cost £50,000, and stands in the railway company's books at that figure. The station is no longer adequate to accommodate the traffic, and an entirely new station is built, costing £125,000. Estimates are prepared which show that the exact cost to-day of replacing the old station would be £75,000. That sum, less the proceeds of sale of the old material, is debited to revenue, or partly provided from revenue and partly from specific reserves, and the new station is capitalised at £125,000.

Typical Example of Double-Account System.—The completest and most elaborate employment of this system is afforded by the accounts of British Railway companies. Examination of a set of Railway accounts will enable the student to appreciate fully the distinctive difference in principle between the double- and single-account systems of presenting accounts. The more important of the accounts published by the premier British Railway are reproduced on pp. 542-48, and the student is invited to study them, since all double-account book-keeping is based upon the principles there exemplified, railway accounting being the parent of the system.

So far as examination work is concerned, no more than general questions on the principles of the system need be anticipated. Such few questions as have been set embracing detail have in the main been

confined to Railway Accounts, and the chief object in setting such questions is to test the student's ability to construct a double-account balance sheet in its two sections from figures given in the question.

The accounts of all parliamentary companies are based upon the principles exhibited by the railway company's accounts here illustrated. The differences arise only from the varying technical details of the particular undertaking concerned. The student who desires to pursue the subject in greater detail, particularly in its application to Gas, Electricity, and Water companies, is referred to the author's *Accounting*, pp. 621–73.

Returning to the Railway accounts that appear on pp. 542-48, it is neither necessary nor possible to reproduce the complete set of accounts as actually published, consisting as they do of some fifty accounts and abstracts, made obligatory by the Act of 1911. Some of these statements are statistical; others are merely schedules analysing and elaborating items that appear in the accounts proper. The four statements reproduced show the net result of the year's working, and the financial position of the undertaking at the close of the year. These four statements are as follows:—

Receipts and Expenditure on Capital Account.—This is the first statement of the sequence of accounts proper and the first section of the Balance Sheet. It conforms strictly to the statutory obligation to show the expenditure of the capital and loan moneys raised for the purpose of acquiring the fixed assets of the undertaking. The numbers appearing in brackets after some of the items refer to subsidiary statements giving the details composing the figures brought into this account. The original cost of all fixed assets purchased is charged in this account. No attempt is made to show the present value of these assets, but the criticisms that once an asset figures in this account it must remain there for ever, and that no provision for wastage can be made, already exposed as inexact, is shown to be false by these accounts, which, in the General Balance Sheet, reveals depreciation and renewal and reserve funds accumulated out of revenue amounting to £38,000,000.

The balance of this section is carried to the General Balance Sheet, and discloses the fact that £20,616,878 has been spent upon fixed assets in excess of the capital actually raised for that purpose. This indicates that liquid assets, or other funds, have been encroached upon to that extent.

The expenditure on capital account is further elaborated in several subsidiary statements that are not reproduced, and which do not concern us here.

Revenue Receipts and Expenditure of the Whole Undertaking.—This account takes the place of the net Profit and Loss Account of the single-account system. The statement shows in summarised form the gross receipts and expenditure, and the net receipts of the various

departments of the undertaking, followed by the income received from investments and miscellaneous sources, and thus arrives finally at the total net income for the year. The results achieved by each

RECEIPTS AND EXPENDITURE ON CAPITAL ACCOUNT.

Dr.

To Expenditure.	Amount expended to December 31, 19...			Amount expended during Year, as per No. 5.			Total.		
	£	s.	d.	£	s.	d.	£	s.	d.
Lines open for Traffic	304,487,132	4	4	448,919	8	5	304,936,051	12	9
Lines not open for Traffic:—									
New Lines	62,334	15	3	14,730	5	10	77,065	1	1
Widenings of and additions to existing Lines	380,984	5	6	138,380	1	2	519,364	6	8
Lines Jointly Owned..	11,817,069	10	1	96,092	6	1	11,913,161	16	2
Lines Jointly Leased..	276,300	0	0				276,300	0	0
Rolling Stock	57,212,531	17	4	1,670,028	8	0	58,882,560	5	4
Manufacturing and Repairing Works and Plant:—									
Land and Buildings	5,388,071	13	3	106,699	19	10	5,494,771	13	1
Plant and Machinery	3,740,004	1	2	332,368	0	9	4,072,372	1	11
Total Capital expended upon Railway	383,364,428	6	11	2,807,218	10	1	386,171,646	17	0
Road Vehicles employed in the collection and delivery of Parcels and Goods, and in the conveyance of Passengers:—									
Goods and Parcels Road Vehicles	758,644	12	6	15,317	19	6	773,962	12	0
Passenger Road Vehicles ..	15,265	1	6				15,265	1	6
Steamboats	3,927,663	10	4	*Cr.* 268,476	5	5	3,659,187	4	11
Steamboat Repairing Works and Plant	144,742	15	6				144,742	15	6
Canals	5,951,050	5	9	*Cr.* 171	4	0	5,950,879	1	9
Docks, Harbours, and Wharves	8,819,390	13	0	69,111	11	9	8,888,502	4	9
Hotels	4,928,930	12	10	38,172	6	1	4,967,102	18	11
Electric Power Stations, etc. ..	2,548,830	19	9	*Cr.* 363,799	5	0	2,185,031	14	9
Land, Property, etc., not forming part of the Railway or Stations:—									
Used in connection with Railway Working	1,296,100	8	8	81,900	9	2	1,378,000	17	10
Not used in connection with Railway Working	14,836,279	13	9	*Cr* 19,783	0	8	14,816,496	13	1
Limestone Quarry	43,334	13	8				43,334	13	8
Subscriptions to other Companies (*for details see Table No. 4 (a)*)	7,557,035	9	5	11,977	16	11	7,569,013	6	4
Stamp Duty, etc., on Additional Capital..				75,000	0	0	75,000	0	0
Northern Counties Railway (Ireland)	5,643,138	10	11	9,063	2	5	5,652,201	13	4
Total Expenditure .. £	439,834,835	14	6	2,455,532	0	10	442,290,367	15	4

department—Railway, Canals, Steamboats, etc.—are shown in separate statements, the totals of which are carried into this account.

Proposed Appropriation of Net Income.—This statement repre-

sents the Appropriation Section of the Profit and Loss Account in the single-account system. It gives the net revenue available and its actual and proposed appropriation. As will be seen, the account is

RECEIPTS AND EXPENDITURE ON CAPITAL ACCOUNT—*cont.*

Cr

By Receipts.				Amount received to December 31, 19. .			Amount received during Year.			Total.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
Shares and Stocks (No. 2)				293,281,009	14	1	6,758,145	0	0	300,039,151	14	1
Debenture Stock (No 3)				107,030,417	15	7				107,030,417	15	7
Premiums on Shares and Stocks	19,516,029	19	7									
Premiums on Debenture Stock . ..	5,122,881	3	6									
Total Premiums	24,638,911	3	1									
Discounts on Shares and Stocks	8,134,842	8	9									
Discounts on Debenture Stock	1,900,151	15	4									
Total Discounts	10,034,994	4	1									
Balance of Premiums and Discounts				14,541,737	7	0	62,179	12	0	14,603,916	19	0
Total Receipts .. ..£				414,853,164	16	8	6,820,324	12	0	421,673,489	8	8
By Balance ..										20,616,878	6	8
Total .. ..£										442,290,367	15	4

presented in tabular form and begins with the balance brought forward from the previous year. To this is added the net revenue for the year as shown in the Revenue Receipts and Payments of the Whole

Undertaking statement, and any transfers from reserve. It will be noted that £1,000,000 has been transferred from general reserve, and a special reserve of £625,821, created to meet a contingency that did not materialise, is also written back to revenue. From the total thus made available are deducted the fixed charges, and shares of profits and rentals due to other companies, and the interest on the guaranteed and preference stocks. The net balance then remaining is the amount available for dividend on the ordinary stock. Inset, at the bottom of the statement, is the proposed appropriation of this balance, subject to the sanction of the shareholders, as between dividend on the ordinary stock, and the "carry forward."

The General Balance Sheet.—This statement discloses the financial position of the undertaking at the close of the year. The statement begins with the balance brought from the "Receipts and Expenditure on Capital Account." If the receipts exceed the expenditure, the balance is a liability; if *vice versa*, the balance appears as an asset, as in this statement. As already explained, all the fixed assets of the undertaking are dealt with in the first section of the Balance Sheet. In this, the final section, only the floating assets and the corresponding liabilities appear.

Reference to the statement on p. 548 will show that large depreciation and renewal funds have been accumulated out of revenue. To create these funds, the departmental revenue account is debited, and the appropriate reserve account is credited, with the amount considered necessary to meet present or future wastage. It has been shown that if these reserves are created to eliminate specific assets, which there is no intention to replace, the asset account is closed at the end of its useful life by a transfer from the reserve account, and thus disappears from the first section of the Balance Sheet.

Ordinary current renewals are charged against revenue as and when they occur. The depreciation funds appearing in the General Balance Sheet are in addition to these charges, and are created in recognition of the fact that wastage has occurred in connection with assets that may not require immediate renewal. Gas companies are under statutory obligation to provide such funds for leaseholds; and Electric Light undertakings for leaseholds, plant and machinery. The latter must invest such funds in outside securities.

In addition to the statutory accounts dealt with above, the Ministry of Transport demands considerable additional detail, the preparation of which involves much book-keeping. But that does not concern us here.

Gas Companies.—The great majority of gas companies are working under special Acts, or are owned by Local Authorities. Local Authorities owning gas undertakings are not bound by the statutory forms of account prescribed by the *Gas Works Clauses Act*, 1871, but in the majority of cases these forms are adopted.

The Capital Account shows the expenditure of the capital raised for the objects of the company. The Revenue Account shows the income derived from the sale of gas, residuals, etc., and the costs of manufacture and distribution. The Reserve Fund is a statutory fund (*Gas Works Clauses Act*, 1847, S. 21 (*c*)).* These accounts are filed with the Clerk of the Peace, and with the Local Authorities of the company's district.

The special Acts under which gas companies operate invariably confer borrowing powers, which are usually limited to one-third of the paid-up capital of the company. Since the Act of 1877, fresh capital issues must be made by public auction, or tender. This regulation is due to the fact that some companies were issuing stock to shareholders at a nominal value, i.e. less than market price. Under the *Gas Regulation Act*, 1920, the Board of Trade has power to prescribe the form of accounts to be employed, but up to the present the Board has not exercised the power.

The Accounts of the Croydon Gas Company are on pp. 549–553.

Electric Lighting Companies.—These companies operate under special Acts of Parliament, or under Provisional Orders granted by the Board of Trade, usually for a period of forty-two years. The form of their accounts is prescribed by the *Electric Light Act*, 1882.

Electricity accounts are very similar in construction to Gas accounts. They must be filed with the Electricity Commissioners, who have power to demand further information, and to revise the prices charged to consumers. Local Authorities have power to purchase an electrical undertaking established in their district at the end of forty years' working.

The accounts of the City of London Electric Lighting Company, Ltd., are on pp. 554–559. It will be noted that the *totals* of the capital receipts and capital expenditure on fixed assets are carried to the General Balance Sheet in place of the *balance* as in the case of Railway and Gas companies.

It will be seen that the accounts of Gas and Electric Light undertakings are based upon precisely the same principles as those of Railway companies, and differ in minor details only.

Water companies usually employ the same system, but they are under no obligation to do so.

* The student is also referred to Sec. 31 of this Act, which deals with the investment of surplus funds.

No. 8.—REVENUE RECEIPTS AND EXPENDITURE OF THE WHOLE UNDERTAKING.

See Statement.		Gross Receipts.			Expenditure.			Net Receipts.			*Previous Year.*		
											Gross Receipts.	*Expenditure.*	*Net Receipts.*
		£	s.	d.	£	s	d.	£	s.	d.	£	£	£
10	Railway	78,991,112	14	8	64,869,155	14	11	14,121,956	19	9	*80,587,890*	*65,791,734*	*14,796,156*
11	Omnibuses and other Passenger Vehicles not running on the Railway	23,446	11	10	38,308	14	1	Dr. 14,862	2	3	*33,896*	*33,159*	*737*
12	Steamboats	1,514,405	1	10	1,560,171	13	10	Dr. 45,766	12	0	*1,572,165*	*1,611,332*	*Dr. 39,167*
13	Canals	153,444	7	3	191,030	4	1	Dr. 37,585	16	10	*153,004*	*204,513*	*Dr. 51,509*
14	Docks, Harbours, and Wharves	677,396	1	11	691,394	6	1	Dr. 13,998	4	2	*690,361*	*713,015*	*Dr. 22,654*
15	Hotels and Refreshment Rooms and Cars where Catering is carried on by the Company	3,420,401	5	9	2,787,594	5	11	632,806	19	10	*3,430,472*	*2,749,209*	*681,263*
16	Limestone Quarry	37,215	0	8	34,959	12	0	2,255	8	8	*47,645*	*42,149*	*5,496*
		84,817,421	3	11	70,172,614	10	11	14,644,806	13	0	*86,515,433*	*71,145,111*	*15,370,322*
	Miscellaneous Receipts (Net):—				£	s.	d.				£	£	
	Rents from Houses and Lands				797,778	1	8					*795,940*	
	Rents from Hotels				2,587	9	0					*2,807*	
	Other Rents, including Lump-sum Tolls				371,207	19	2					*334,673*	
	Interest and Dividends from Investments in other Companies:—	£	s.	d.									
	County Donegal Railways Joint Committee	12,277	5	2							*12,277*		
	Great Northern Railway (Ireland)	152	0	0							*152*		
	Great Southern Railways	9,823	9	6							*11,336*		
	Great Western Railway	4,250	0	0							*4,250*		
	London and North-Eastern Railway	12,185	0	0							*12,185*		
	London Electric Railway..	32,992	3	9							*32,865*		
	Midland and Great Northern Railways Joint Committee	16,020	7	8							*16,020*		
	Somerset Joint Committee	64,559	18	11							*64,559*		
	Tottenham and Hampstead Joint Committee	35,200	7	6							*35,200*		
					187,460	12	6					*188,844*	
	Transfer Fees				8,868	13	3					*9,231*	
	Joint Lines (Abstract J): Company's proportion of Receipts other than those in respect of Railway Working				44,153	0	10					*47,606*	
	General Interest				1,847,205	4	0					*1,735,841*	
	Great Western Railway Company: Moiety of Shrewsbury and Welshpool and Vale of Towy Dividends				7,500	0	0					*7,500*	
	London and North-Eastern Railway Company: Moiety of Dundee and Arbroath Railway Guaranteed Interest				11,807	10	0					*11,807*	
	Metropolitan District Railway Company (Richmond Extension)				7,750	0	0					*7,375*	
	Northern Counties Railway (Ireland)				70,850	15	1					*114,112*	
								3,357,169	5	6			*3,255,736*
	Total Net Income				.. .. .. £			18,001,975	18	6			*18,626,058*

No. 9.—PROPOSED APPROPRIATION OF NET INCOME.

	£	s.	d.	£	s.	d.	£	s.	d.	Previous Year. £	Previous Year. £
Balance brought forward from last year's Account							270,137	3	1		341,549
Net Income (as per Revenue Receipts and Payments of the Whole Undertaking)							18,001,975	18	6		18,626,058
Appropriation from Reserve							1,000,000	0	0		1,300,000
Contingent Receipts Suspense Account now released							625,851	0	0		
Total							19,897,964	1	7		20,267,607
Deduct—Interest, Rentals, and other Fixed Charges:—											
Interest on Superannuation and other Funds				868,973	19	0				671,047	
Rent Charges (or Feu Duties) and Annuities				89,793	7	10				89,692	
Chief Rents, Wayleaves, etc., including Lump-sum Tolls				193,828	16	6				164,642	
Interest on 4 % Debenture Stock				4,071,642	15	2				4,071,643	
Rents of Leased and Worked Lines and Guaranteed Interest:—											
Birkenhead Railway	49,499	2	5							49,499	
Bridgwater Railway	800	0	0							800	
Great Central and Midland Joint Lines	35,000	0	0							35,000	
Midland and Great Northern Joint Railways	18,000	0	0							18,000	
Richmond Extension Line	14,000	0	0							14,000	
Shrewsbury and Hereford Railway	19,875	0	0							19,875	
Tenbury Railway	675	0	0							675	
Tottenham and Hampstead Joint Line	19,712	4	2							19,712	
West London Railway	2,007	14	8							2,008	
				159,569	1	3				159,569	
Joint Lines (Abstract J): Company's proportion				60,962	12	4				60,683	
Birmingham Canal				39,601	13	8				23,896	
							5,484,372	10	9		5,241,372
Balance after payment of Fixed Charges							14,413,591	10	10		15,026,235
Dividends on Guaranteed and Preference Stocks:—											
4 % Guaranteed Stock				1,627,716	12	10				1,627,717	
4 % Preference Stock				4,756,350	9	8				4,756,351	
4½ % Redeemable Preference Stock (Redeemed June 30, 1925)				33,750	0	0				67,500	
5 % Redeemable Preference Stock (1926)				35,000	0	0				35,000	
5 % Redeemable Preference Stock (1955)				393,953	12	6					
4 % Preference Stock (1923)				1,605,359	9	6				1,605,359	
							8,452,130	4	6		8,091,927
Balance available for Dividend on Ordinary Stock £							5,961,461	6	4		6,934,308
				£	s.	d.					
Dividend on Ordinary Stock at 6 % per annum				5,712,146	9	2				(7 %) 6,664,171	
Balance carried forward to next year's Account				249,314	17	2				270,137	
Total £				5,961,461	6	4				6,934,308	

GENERAL BALANCE SHEET.

Dr.

	£	s	d	£	s.	d.	Previous Year. £
To Unpaid Interests and Dividends				76,852	17	6	75,149
,, Interest and Dividends payable or accruing and provided for..				2,107,701	14	9	2,090,992
,, Amount due to Railway Companies and Committees..				1,248,441	15	8	1,431,340
,, Savings Bank				6,791,217	18	7	6,358,776
,, Superannuation and other Provident Funds				21,655,232	7	5	19,960,272
,, Accounts payable				5,438,248	5	3	5,802,531
,, Liabilities accrued				862,294	10	5	1,115,484
,, Miscellaneous Accounts				3,126,614	0	2	4,094,804
,, Forged Transfer Act Fund				26,541	16	9	25,763
,, Compensation Fund				208,619	6	2	217,037
,, Fire Insurance Fund				1,638,426	19	1	1,606,462
,, Depreciation Funds:—							
Railway				24,137,954	3	1	26,095,679
Steamboats (including Insurance Fund)..				3,052,578	17	11	3,226,635
Other Businesses				934,893	14	10	870,869
,, General Reserve Fund				10,288,066	12	2	11,288,067
,, Balance available for Dividends and Reserve, as per Account No. 9	14,413,591	10	10				15,026,235
Less Interim Dividends paid, as per Account No. 9 (*a*)	6,613,524	6	6				6,902,037
				7,800,067	4	4	8,124,198
£				89,393,752	4	1	92,384,058

Cr.

	£	s.	d	Previous Year. £
By Capital Account: Balance at Debit thereof as per Account No. 4	20,616,878	6	8	24,981,671
,, Cash at Bankers and in hand	7,950,606	9	1	6,863,576
,, Investments in Government and other Securities	34,138,520	14	9	35,884,483
,, Investments in Stocks and Shares held by the Company and advances to other Companies not charged as Capital Expenditure	716,661	8	5	697,606
,, Stock of Stores and Materials	9,992,428	17	3	9,742,973
,, Outstanding Traffic Accounts	6,318,157	7	6	6,124,698
,, Amount due by Railway Companies and Committees	569,023	13	6	694,332
,, Amount due by Railway Clearing Houses	263,588	0	11	424,511
,, Amount due by Postmaster-General	268,216	18	11	282,277
,, Accounts Receivable	1,301,014	9	9	1,760,110
,, Advances to Staff for Housing	278,237	3	7	33,259
,, Miscellaneous Accounts	6,948,815	4	9	4,864,978
,, Dividends to be received on Shares held by the Company	31,603	9	0	29,584
£	89,393,752	4	1	92,384,058

THE CROYDON GAS COMPANY.

C.—CAPITAL ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..

Dr. Cr.

	Total Expended for Year.			Total Expenditure to December 31, 19. .				Receipts to December 31, last Year.			Received during Year.			Total Receipts to December 31, 19 ..		
	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.	£	s.	d.
To Expenditure to December 31, last year				1,166,781	6	10	By Ordinary Capital— Sliding Scale Stock	660,000	0	0	77,150	0	0	737,150	0	0
Since that date—							Maximum Dividend Stock ..	284,975	0	0	118,125	0	0	403,100	0	0
„ Land, New Buildings, Manufacturing Plant, and other Structures connected with Manufacture	80,588	0	2				7½ % Preference Stock (1936)..	120,000	0	0				120,000	0	0
„ New Mains and Service Pipes, including laying of same, and other works connected with Distribution	25,843	5	8				„ Loan Capital— 5 % Debenture Stock	54,540	0	0						
„ New Meters (additional)	3,415	8	10				4 % Debenture Stock	97,310	0	0						
							7 % Redeemable Debenture Stock (1940)	115,000	0	0				336,850	0	0
							6 % Redeemable Debenture Stock (1932)	70,000	0	0						
				109,846	14	8	„ Premium Capital— On Issues of Ordinary Capital	118,314	19	0						
							On Issues of Loan Capital .	15,708	10	4	Dt. 16,189	0	0	117,834	9	4
				1,276,628	1	6		1,535,848	9	4	179,086	0	0	1,714,934	9	4
„ Balance of Capital Account . ..				52,346	7	10	*Less*— Nominal amount added on Conversion							385,060	0	0
			£	1,328,974	9	1							£	1,328,974	9	4

D.—REVENUE ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.

	£	s	d	£	s.	d.
To Manufacture of Gas—						
Coal, Oil, etc.	287,626	8	7			
Purification	3,144	9	2			
Salaries	10,221	19	2			
Wages and Gratuities	30,837	19	3			
Repair and Maintenance of Works, Plant, etc., including Renewal of Retorts, Materials, and Labour	69,267	3	2			
				401,097	19	4
,, Distribution of Gas—						
Salaries	32,561	0	1			
Repair and Renewal of Mains, Service Pipes, etc., including Materials, Paving, and Labour	31,078	11	8			
Repairing and Renewing Meters	13,802	0	2			
Repairing, Renewing, and Fixing Gas Stoves	21,126	16	10			
House Fittings	976	5	4			
				99,544	14	1
,, Public and Contract Lamps—						
Lighting and Repairing				8,196	4	7
,, Rents and Rates—						
Rents Payable	1,280	10	6			
Rates	14,760	17	1			
				16,041	7	7
,, Management—						
Directors' Allowance	3,600	0	0			
Salaries	6,709	7	3			
Collection	13,352	16	6			
Auditors' Fees	400	0	0			
				24,062	3	9
,, Sundries—						
Stationery and Printing	2,217	18	5			
General Charges, Advertising, etc.	7,642	3	5			
Law, etc., Charges	305	3	10			
Depreciation Fund on Works on Leasehold Lands	6	16	0			
Bad Debts	622	19	0			
Superannuations and Pension Fund	8,964	11	0			
Workmen's Sick and Burial Fund	648	19	0			
Workmen's Superannuation Fund	346	4	6			
Co-partnership	10,284	15	3			
State Insurance	1,613	11	8			
				32,653	2	1
Total Expenditure				581,595	11	5
Balance carried to Net Revenue Account (E)				99,969	18	7
				£681,565	10	0

E.—NET REVENUE ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.

	£	s	d.
To Interest on Debenture Stocks and Mortgages	18,869	8	0
,, Interest on Deposits for Gas	118	10	0
,, Interest	6,805	7	7
,, Income Tax	—	—	—
,, Dividend for Half-year ended June 30, 19..	34,347	13	7
,, Balance of Net Profit available for Dividends to December 31, 19..	46,983	0	7
	£107,123	19	9

D.—REVENUE ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..—*continued*.

Cr.

	£	s.	d.	£	s.	d.
By Sale of Gas—						
Private Consumers—(60,477)						
Croydon and Carshalton Districts at 8½d. and 9½d. per Therm	447,835	7	5			
Caterham District at 9½d. and 10½d. per Therm .	29,819	15	11			
Public and Contract Lighting	16,717	14	3			
				494,372	17	7
„ Rental of Meters—						
Ordinary: Company's 32,496						
Consumers' 349	19,428	11	6			
Prepayment 27,632						
„ Rental of Gas Stoves (Cooking, 40,476; Heating, 21,198).	23,455	14	4			
„ Rental of House Fittings	6,512	14	1			
				49,396	19	11
„ Sale of Residual Products—						
Coke, *less* Labour and Cartage	96,884	11	11			
Breeze, *less* Labour and Cartage	20,401	13	9			
Tar, *less* Labour and Cartage	12,644	9	4			
Sulphate of Ammonia, *less* Labour and Cartage ..	6,804	2	8			
				136,734	17	8
„ Rents Receivable				1,060	14	10
				£681,565	10	0

Note.—Paid for Wages, Salaries, and Bonus during the last 3 years—
19..—£191,217
19..—£179,015
19..—£166,128

E.—NET REVENUE ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..—*continued*.

Cr.

	£	s.	d.	£	s.	d.
By Balance from last Account	39,545	14	1			
Less Dividends for the Half-year ended December 31, last year	33,074	7	6			
				6,471	6	7
„ Income Tax				632	14	7
„ Balance from Revenue Account (D), being Profit for the year ended December 31, 19..				99,960	18	7
				£107,123	19	9

F.—RESERVE FUND ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..

DR.

	£	s.	d.
To Amount to be carried to next Account	* 59,235	11	5
* Invested in—			
£7,082 4s. 1d. War 5 % Stock, 1929/47			
£15,221 15s. 4d. 3½ % Conversion Stock, 1961			
£13,028 13s. 2d. 3 % Transvaal Guaranteed Stock, 1923/53 } £26,544 10 0			
£950 0s. 0d. 3 % Bournemouth Debenture Stock			
	£59,235	11	5

G.—INSURANCE FUND ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..

DR.

	£	s.	d.
To Compensations for Accidents, etc.	1,194	2	11
,, Amount to be carried to next Account	† 24,760	13	11
† Invested in—			
£7,500 0s. 0d. War 5 % Stock, 1929/47			
£5,097 0s. 0d. 3½ % Conversion Stock, 1961 } £10,810 0 0			
£2,250 0s. 0d. 3 % Bournemouth Debenture Stock			
	£25,954	16	10

M.—GENERAL BALANCE SHEET ON DECEMBER 31, 19..

DR.

	£	s.	d.	£	s.	d.
To CAPITAL ACCOUNT (C) Balance				52,346	7	10
,, NET REVENUE ACCOUNT (E) Balance				46,983	0	7
,, RESERVE FUND ACCOUNT (F) Balance				59,235	11	5
,, INSURANCE FUND ACCOUNT (G) Balance				24,760	13	11
,, RENEWAL FUND ACCOUNT (H) Balance				4,697	12	2
,, TRUSTEES OF PENSION AND WIDOWS AND ORPHANS' FUNDS	112,898	8	9			
Less INVESTED ‡	45,000	0	0			
				67,898	8	9
,, CO-PARTNERSHIP TRUSTEES..				14,147	6	2
,, Creditors—						
Unpaid Dividends	103	4	3			
Unpaid Debenture Interest	28	18	6			
Plant, Coal, Stores, etc.	93,304	7	10			
Deposits for Gas and Interest	3,255	5	7			
Interest on Debenture Stocks and Mortgages	9,434	14	0			
Temporary Loan	—	—	—			
				106,126	10	2
‡ £51,763 9s. 9d. 3½ % Conversion Inscribed Stock, 1961.						
£6,338 15s. 2d. 3½% 1945 Queensland Inscribed Stock.						
				£376,195	11	0

F.—RESERVE FUND ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..—*continued.*

Cr.

	£	s.	d.
By Balance from last Account..	56,616	13	7
,, Interest ..	2,618	17	10
	£59,235	11	5

G.—INSURANCE FUND ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..—*continued.*

Cr.

	£	s.	d.
By Balance from last Account..	24,769	4	6
,, Interest .	1,185	12	4
	£25,954	16	10

M.—GENERAL BALANCE SHEET ON DECEMBER 31, 19..—*cont.*

Cr.

	£	s.	d.	£	s.	d.
By Cash at Bankers ..	23,184	19	10			
,, Cash at Offices ..	282	8	4			
				23,467	8	2
,, Treasury Bills ..				19,810	12	3
,, Amounts invested—						
Reserve Fund ..	26,544	10	0			
Insurance Fund ..	10,810	0	0			
				37,354	10	0
,, Stock—						
Coal and Oil ..	30,512	3	1			
Coke and Breeze ..	1,740	12	0			
Tar, Liquor, and Sulphate of Ammonia ..	4,741	9	2			
Sundry Stores ..	46,539	6	10			
				83,533	11	1
,, Debtors—						
Gas, etc., to:						
September 30, 19.. .. £1,910 3 5						
December 31, 19.. .. 114,454 12 5						
	116,364	15	10			
Coke and other Residuals ..	16,432	4	4			
Sundries ..	16,610	11	2			
				149,407	11	4
,, Gas Stoves, etc. ..				59,360	3	1
,, Motor Vehicles ..				3,255	15	1
,, Capital Account (C) Balance ..				—	—	—
				£376,195	11	0

THE CITY OF LONDON ELECTRIC LIGHTING COMPANY, LTD.

No. I.—STATEMENT OF SHARE CAPITAL AUTHORISED AND ISSUED AT DECEMBER 31, 19...

Description of Capital.	Authorised by	Number of Shares Issued.	Nominal Amount of Shares.	Payable per Share.	Total Paid up.	Instalments Unpaid.	Remaining Unissued.	Total Amount Authorised.
			£	£	£		£	£
400 000 6 % First Preference Shares ..	Memorandum and Articles of Association	400,000	1	1	400,000	Nil	Nil	400,000
800 000 Ordinary Shares	Memorandum and Resolution of February 24, 1897	800,000	1	1	800,000	Nil	Nil	800,000
300 000 8 % *Second Preference Shares* ..	Resolution, April 14, 1920	300,000	1	1	300,000	Nil	Nil	300,000
£500 000 as yet undenominated	Resolution, April 14, 1920	Nil	—	—	Nil	—	500,000	500,000
					£1,500,000	Nil	£500,000	£2,000,000

No. II.—STATEMENT OF LOAN CAPITAL AT DECEMBER 31, 19...

Description of Loan.	Created.	Issued and Received.	Borrowing Powers
	£	£	
Five per cent. First Debenture Stock (redeemable at £125 %)..	400,000	400,000	The Directors are authorised to borrow a total amount which, including the Debenture Stocks of the Company outstanding and any premium payable thereon on redemption, shall not at any time exceed the subscribed capital of the Company.
Four and a half per cent. Second Debenture Stock (redeemable at Par)	400,000	400,000	

No. III.—CAPITAL ACCOUNT AT DECEMBER 31, 19...

(Including preliminary adjustments rendered necessary by the agreement with the L.C.C.)

Dr. | Cr.

Item No.	Expenditure.	Total to Dec. 31, last year. £	s.	d.	Added during Year. £	s.	d.	Written off during Year. £	s.	d.	Total to Dec. 31, 19... £	s.	d.	Item No.	Receipts.	Total to Dec. 31, 19... £	s.	d.
1	To Machinery and Plant, Boilers, Pumping, Feed-heating Appliances, Engines, Dynamos, Alternators and Exciters	1,046,125	6	1	168,840	7	1	36,932	6	6	1,178,033	6	8	1	By 800,000 Ordinary Shares of £1 each	800,000	0	0
2	,, Mains and Conduits	868,276	10	9	48,798	18	8	1,576	18	8	915,498	10	9	2	,, 400,000 6% First Preference Shares of £1 each ..	400,000	0	0
3	,, Wiring and Fittings on Hire ..	256	1	5				41	1	10	214	19	7					
3A	,, Street Lighting Equipment	28,334	16	4	113	2	3				28,447	18	7					
4	,, Transformers and Accessories ..	95,528	19	2	42,642	3	2	12,350	19	2	125,820	3	2	3	,, 300,000 8% Second Preference Shares of £1 each ..	300,000	0	0
5	,, Meters and Electrical Instruments	107,712	2	10	5,175	18	11	946	13	2	111,941	8	7					
6	,, Lamps and Accessories on Consumers' premises	4,932	8	3							4,932	8	3	4	,, 5% First Debenture Stock ..	400,000	0	0
7	,, Tools and Plant	7,443	15	7	8,489	19	8	264	1	3	15,669	14	0					
8	,, Costs of obtaining three Provisional Orders under agreements with Contractors, and expenses in connection with 1893, 1900, and 1908 Acts, etc.	15,857	7	10							15,857	7	10	5	,, 4½% Second Debenture Stock .	400,000	0	0
																2,300,000	0	0
9	,, Office Furniture and Fixtures ..	4,938	16	9	9,112	17	6	1,234	14	2	12,817	0	1		Liability. ,, Premium due on redemption of First Debenture Stock provided out of Reserve Account	100,000	0	0
	£	2,179,406	5	0	283,173	7	3	53,346	14	0	2,409,232	17	6					
10	,, Freehold and Leasehold Land and Buildings, including Law Charges incidental to acquisition	541,249	9	9	46,350	12	3	1,807	3	1	585,792	18	11		,, Amount advanced from Reserve Funds	682,427	12	8
11	,, Southwark Order, 1891—Cost of obtaining Provisional Order, Expenditure on Mains, Meters, etc.	84,457	6	3	3,310	17	10	366	7	10	87,401	16	3					
	Total .. .. £	2,805,113	1	0	332,834	17	4	55,520	5	8	3,082,427	12	8		£	3,082,427	12	8

No. IV.—REVENUE ACCOUNT FOR TWELVE MONTHS ENDED DECEMBER 31, 19...

Dr. | *Cr.*

Item No.	Expenditure.	£	s.	d.	Item No.	Income.	£	s.	d.
	GENERATION OF ELECTRICITY.								
1	To Coal and other Fuel, including dues, carriage, unloading, storing, and all expenses of placing the same on works	134,967	14	3	1	By Sale of Current	743,953	14	1
2	,, Oil, Waste, and Engine-room Stores	1,516	1	11	2	,, Revenue under Contracts	4,372	0	0
3	,, Water	1,507	17	10	3	,, Revenue from Street Lighting	10,715	12	1
4	,, Proportion of Salaries of Engineer and Assistants	40,353	0	0	4	,, Meter Rentals	19,181	11	7
5	,, Wages and Gratuities at Generating Station	46,663	2	4	5	,, Rents receivable	9,358	13	2
6	,, Sundry Expenditure	1,853	4	7	6	,, Transfer and Probate Fees	148	12	0
7	,, Repairs of—				7	,, Sundry Receipts and Testing Fees	573	8	0
	Buildings	1,709	0	5					
	Boilers, Heaters, etc.	7,895	9	8					
	Engines, Condensers, Dynamos, and Exciters	3,224	10	7					
	Transformers, Balancers, etc.	822	0	11					
	Coal Conveyor, Cranes, etc.	2,086	0	10					
	Other Machinery, Instruments and Tools	4,146	8	1					
	Generation Expenses	246,744	11	5					
	DISTRIBUTION OF ELECTRICITY.								
8	To Proportion of Salaries of Engineer and Assistants	14,129	17	5					
9	,, Attending Mains, Street Boxes, and Distributing Sub-Stations	6,055	13	7					
10	,, Repairs and Maintenance of Meters, Mains, and Distributing Sub-Stations	8,465	8	7					
11	,, Maintaining and Trimming Arc Lamps on Consumers' Premises, Carbons, and Sundry Expenses	1,691	10	5					
12	,, Street Lighting, Repairs, Maintenance, Carbons, and Trimming Expenses	7,996	16	9					
	Generation and Distribution Expenses	285,083	18	2					
	RENTS, RATES, AND TAXES.								
13	,, Rents and Wayleaves	19,867	9	6					
14	,, Rates and Taxes	85,497	6	9					
	MANAGEMENT EXPENSES.								
15	,, Directors' Remuneration, Salaries of Joint Managing Directors, Secretary, Clerks, etc.	28,815	18	1					
16	,, Collecting Expenses	3,559	13	10					
17	,, Printing and Stationery	2,170	9	0					

Item No.		£	s.	d.			£	s.	d.
18	,, General Establishment Charges	1,371	4	5					
19	,, Postages and Stamps	1,095	3	9					
20	,, Insurance	4,766	6	5					
21	,, Advertising, etc.	847	7	9					
22	,, Meter Reading	2,961	15	9					
23	,, Auditors' Fees	275	2	0					
24	,, Trustees' Fees	210	0	0					
	PROFESSIONAL AND OTHER CHARGES.								
25	,, Legal and Professional Charges	578	13	3					
26	,, Testing of Meters—Corporation of London	576	18	0					
27	,, Repairs to Properties sub-let	600	13	7					
28	,, Compulsory contribution towards the salaries and expenses of the Electricity Commissioners	749	1	10					
	Total Expenditure	439,027	2	1					
	,, Balance, being Revenue for period, carried to Net Revenue Account	349,276	8	10					
	£	788,303	10	11		Total Income .. .. £	788,303	10	11

No. V.—NET REVENUE ACCOUNT FOR TWELVE MONTHS ENDED DECEMBER 31, 19...

Dr. Item No.		£	s.	d.	Item No.	Cr.	£	s.	d.
1	To Interest on £400,000 5 % First Debenture Stock, *less* tax, year to December 31 .. .. £15,500 0 0				1	By Balance from last Account £162,632 5 9			
	,, Interest on £400,000 4½ % Second Debenture Stock, *less* tax, year to December 31 .. .. 13,950 0 0					*Less* Dividends declared March 26, 19.. .. .. 129,150 0 0	33,482	5	9
		29,450	0	0	2	,, Balance from Revenue Account to December 31, 19.., as above	349,276	8	10
2	,, Interest on Loans from Bankers, Deposits, etc. ..	17,401	13	11	3	,, Interest on Investments (*less* Income Tax)	4,250	3	0
3	,, Amount transferred to Reserve Account	160,000	0	0	4	,, Discounts on Purchases	1,998	7	3
4	,, Provision for Bad Debts	500	0	0					
5	,, Provident Fund	2,526	2	5					
6	,, Benevolent Fund	10,967	0	0					
7	,, Stock Adjustment	566	3	9					
		221,411	0	1					
	,, Balance as per General Balance Sheet	167,596	4	9					
	£	389,007	4	10		£	389,007	4	10

No. VI.—RESERVE ACCOUNT AT DECEMBER 31, 19..

Dr. | Cr.

Item No.		£	s.	d.	Item No.		£	s.	d.
1	To total amount appropriated in writing off works dismantled and replaced, and other items during the period 1891 to end of the year. Of which has been written off Capital Account, £850,219 11s. 6d.	1,197,916	18	4	1	By total amount provided from Revenue and other sources during the period to end of last year	1,749,238	10	8
					2	,, Value of old Stores resulting from Works dismantled in 19.. (mostly sold)	6,704	10	11
2	,, Amount written off Capital for year	55,520	5	8	3	,, Amount transferred from Revenue	160,000	0	0
3	,, Change of Pressure ..	20,970	7	7	4	,, Contingency Reserve Fund	20,007	12	0
4	,, Balance at December 31, 19..	721,543	2	0	5	,, Dividend Equalisation Fund	60,000	0	0
		£1,995,950	13	7			£1,995,950	13	7

No. VII.—GENERAL BALANCE SHEET AS AT DECEMBER 31, 19..

DR. CR.

Item No.	Capital, Liabilities, etc.	£	s.	d.
1	To CAPITAL ACCOUNT—Amount received as per Statement No. III	2,300,000	0	0
1A	,, PREMIUM DUE ON REDEMPTION OF FIRST DEBENTURE STOCK	100,000	0	0
2	,, SUNDRY TRADESMEN and others, amount due for construction of Plant and Machinery, Stores, etc.	105,567	9	3
3	,, SUNDRY CREDITORS on Open Accounts	116,419	17	5
4	,, UNCLAIMED DIVIDENDS	357	11	1
5	,, SUNDRY DEPOSITS from Employees	161,175	18	9
6	,, SUNDRY DEPOSITS from Consumers	17,779	0	4
7	,, SUNDRY DEPOSITS from Tenants	25	11	9
8	,, RESERVE FOR BAD AND DOUBTFUL DEBTS £654 15 8			
	Less Debts written off during year .. 538 7 11	116	7	9
9	,, RESERVE ACCOUNT (Statement No. VI)	721,543	2	0
10	,, PROFITS ON SALE OF INVESTMENTS	13,992	6	6
11	,, NET REVENUE ACCOUNT—			
	Balance at credit thereof .. £167,596 4 9			
	Less Dividend paid on account:			
	On £400,000 First Preference Shares (*less* tax) £9,300 0 0			
	On £300,000 Second Preference Shares (*less* tax) 9,300 0 0			
	On £800,000 Ordinary Shares (*less* tax) .. 31,000 0 0 — 49,600 0 0			
	Leaving to be dealt with as proposed in Report . ..	117,996	4	9
	£	3,654,973	9	7

Item No.	Capital Expenditure and Assets.	£	s	d.
1	By CAPITAL EXPENDITURE as per Statement No. III.	3,082,427	12	8
2	,, STORES at Stations and elsewhere	80,640	10	0
3	,, SUNDRY DEBTORS, for current supplied—			
	To September 19.. .. .. . £640 8 3			
	To December 19.. .. .. 208,691 12 11	209,332	1	2
4	,, OTHER DEBTORS and payments in advance	11,113	2	5
5	,, CASH AT BANKERS, and in hand	23,816	2	4
6	,, INVESTMENTS—(At Cost) .. .. (Including Shares in Bankside Finance and Industries, Limited)	247,644	1	0
	£	3,654,973	9	7

EXAMINATION QUESTIONS.

1. Differentiate between the terms "double-account system" and "double-entry system."

In what classes of undertaking is the former system used? (*London Chamber Commerce.*)

2. What is meant by the Double-Account System and to what class of undertakings does it apply? Draw up a *pro forma* Balance Sheet on the double-account system. (*Incorporated Accountants.*)

3. Briefly describe the dominating principle which governs the form in which the accounts of Parliamentary Companies working under the double-account system are framed. (*Royal Society Arts.*)

4. Briefly contrast the double- and single-account systems of presenting accounts. It is sometimes stated that no adjustments of the assets shown in the Capital Account of a parliamentary company are possible. Criticise this statement. (*Chartered Institute Secretaries.*)

5. "Companies to which the double-account system is applied are deemed to be permanent undertakings, and, provided they maintain an equivalent equipment to that with which they started, provision for depreciation is unnecessary."

Do you approve of this statement? Give reasons for your opinion, and, if you consider that such provision is necessary, state how it can be effected in accounts prepared under this system. (*Chartered Accountants.*)

6. A text-book states that, under the double-account system, "Capital Expenditure is stated at its original cost price at which it must remain, no adjustment of the assets being permitted."

Briefly state your views with reference to the above contention. (*Chartered Accountants.*)

7. From the following figures prepare the Receipts and Expenditure on Capital Account and General Balance Sheet of the Loamshire Railway Company for the year ended December 31, 19.. :—

Lines open for Traffic, expended to December 31, 19.., £36,417,534; Ditto, expended during the year, £64,335; Steamboats, expended to December 31, 19.., £741,685; Ditto, expended during the year, £436,462; Rolling Stock, expended to December 31, 19.., £7,542,641; Ditto, expended during the year, £192,432; Hotels, expended to December 31, 19.., £394,446; Ditto, expended during the year, £5,962; Stocks and Shares issued to December 31, 19.., £30,230,441; Ditto, received during the year, £4,212,402; Debentures, issued to December 31, 19.., £10,105,166; Ditto, received during the year, £1,240,000; Superannuation Fund, £2,413,678; Cash at Bankers, £568,321; Accounts Payable, £1,241,632; Depreciation Fund, £2,161,321; Stocks, Stores, and Materials, £2,664,675; Investments, £2,311,377; Outstanding Traffic Accounts, £1,968,431; Unpaid Interest, £9,642; General Reserve Fund, £3,000,000; Net Revenue Account (Credit Balance), £1,261,430; Accounts Receivable, £2,567,411. (*Royal Society Arts.*)

8. From the following particulars draw up (1) the Balance Sheet of a company as on June 30, 19.., on the single-account system, and (2) the Capital Account and General Balance Sheet as on the same date on the double-account system: Nominal Capital, £300,000; Subscribed Capital, £260,000; Debentures at 5 %, £40,000; Trade Creditors, £16,000; Reserve, £15,000; Trade Debtors, £38,000; Cash in hand and in Bank, £35,000; Investments (Reserve), £15,000; Stock, £24,000.

Expenditure to previous June 30: Land, £12,000; Shafting, etc., £135,000; Machinery, £40,000; Buildings, £13,000.

The expenditure during the year ended June 30, 19.., was £25,000, £25,000, and £10,000 on the last three items, and a Depreciation Fund of £25,000 had been created. The balancing item of £16,000 may be taken, for the purposes of this question, as profit of the company.

In what cases is the double-account system compulsory by Act of Parliament?

What advantages and disadvantages does this system possess?

Illustrate your answer from the above problem. (*Incorporated Accountants.*)

9. From the following figures of the Townway Railway Company, prepare the Capital Account for the year ended March 31, 19.., and the General Balance Sheet as at March 31, 19.. :—

Expenditure and Receipts to previous March 31: Permanent Way and Overhead Equipment, £451,500; Buildings, £3,000; Power Station, £210,000; Rolling Stock, £60,000; 6 % Debentures, £150,000; 8 % Preference Shares, £300,000; Ordinary Shares, £300,000.

Expenditure and Receipts of the year: Permanent Way, etc., £60,000; Power Station, £15,000; Rolling Stock, £1,800; Ordinary Share Capital, £150,000; Reserve Fund, £150,000; Creditors, £38,520; Depreciation Fund, £75,000; Investments, £180,000; Stocks and Stores, £28,000; Cash in hand and at Bank, £154,220. (*Incorporated Accountants.*)

10. Give the forms of accounts for railways as prescribed by Act of Parliament, namely: Receipts and Expenditure on Capital Account; Revenue Account; Net Revenue Account; General Balance Sheet; and enter up each of the following items in its appropriate account:—

	£	£
Expenditure on Line open for Traffic	1,000,000	
Expenditure during Current Half-year on Traffic	210,000	
Share Capital received		1,100,000
Share Capital received during Current Half-year		50,000
Maintenance of Ways, Works, and Stations ..	10,000	
Traffic Receipts		100,000
Interest on Loans	1,000	
Cash at Bankers	70,000	
Temporary Loans		50,000
General Stores	9,000	
	£1,300,000	£1,300,000

(*Incorporated Accountants.*)

11. Draw up from the following figures a Revenue Account, Net Revenue Account, and General Balance Sheet of the East and West Railway in the prescribed forms: Maintenance of Way, £7,033; Locomotive Power, £9,909; Passengers Carried, £18,418; Parcels Carried, £4,078; Rates and Taxes, £2,056; Rent Charges and Chief Rents paid, £533; Mails Carried, £669; Merchandise Carried, £13,651; Minerals Carried, £14,348; Traffic Expenses, £9,235; Rent paid on Leased Line, £2,062; Carriage and Wagon Repairs, £2,580; Interest on Debenture Stock, £4,217; Credit Balance from last half-year's Revenue Account, £576; Forged Transfers Fund, £597; Compensation (accidents and losses), £439; Debts due to other Companies, £569; Rent Charge, Stock Guaranteed Dividend, £2,602; Sundry Creditors, £11,994; Invested in Consols, £502; General Stores, Stock on hand, £10,653; Cash at Bankers, £11,038; Bank and General

Interest, £80; Fire Insurance Fund, £1,716; Traffic Accounts due to Company, £7,269; Balance at credit of Capital Account, £3,432. (*Chartered Accountants.*)

12. Draw out Trial Balance, and prepare Balance Sheet setting out the headings thereon in the order that seems to you applicable.

Balance to debit of Capital Account, £4,292,000; Amounts due to other Railway Companies and Committees, £258,550; Amounts due to Railway Clearing House, £24,850; Amounts due by Railway Clearing House, £43,231; Amounts due by Postmaster-General, £134,833; Investments in Government Securities, £8,120,000; Amount to credit of Savings Bank Committee, £2,270,154; Amount to credit of Superannuation and other Provident Funds, £2,142,908; Accounts payable by Company, £1,119,584; Fire Insurance Fund, £507,377; Railway Depreciation Fund, including arrears of Deferred Maintenance, £9,839,456; Steamboat Depreciation Fund, £1,503,013; Depreciation Funds Subsidiary Businesses, £514,760; Investments in Stocks and Shares of other Companies, £1,343,626; Stock of Stores and Material, £1,898,231; Amounts due by other Railway Companies and Committees, £534,584; Dividends and Interest unclaimed, £81,907; Investments on account of Superannuation and other Funds, £125,000; General Reserves, £750,000; Reserves for Contingencies, £1,250,000; Interest and Dividends payable by Company and accruing or provided for, £609,660; Interim Dividends paid, £1,855,770; Traffic Accounts Receivable, £501,515; Cash on Deposit at Interest, £4,920,000; Balance at Bank, £1,820,000; Cash in hand, £114,525; Liabilities accruing, £620,797; Balance of Account No. 9 available for Dividends and Reserves, £5,011,808; Amounts Receivable, £801,509. (*Incorporated Accountants.*)

13. The books of the Wellesley Electric Lighting Corporation, Ltd., show the following Receipts and Payments on Capital Account for the first year ended December 31, 19..: Ordinary Shares of £10 each, £30,000; Preference Shares of £10 each, £25,000; Lands Purchased, £6,000; Buildings, £7,400; Machinery, £15,000; Distributing Stations, £2,000; Mains, £10,000; Transformers, £500; Meters, £1,500; Instruments, £150; Furniture, £50; Tools, £30; Provisional Order and Law Costs, £5,000.

The following additional expenditure was made during the following year: Buildings, £140; Machinery, £100; Distributing Stations, £185; Transformers, £65; Meters, £20; Instruments, £10; Tools, £10; Public Lamps, £114. Prepare the statutory Capital Account of the Company as at the close of the second year. (*Incorporated Accountants.*)

CHAPTER XIV

DEPARTMENTAL AND BRANCH ACCOUNTS. FOREIGN BRANCH ACCOUNTS

I. DEPARTMENTAL ACCOUNTS.

WHEN a selling organisation is conducted on modern lines, whether it be a wholesale or a retail organisation, the business is usually sub-divided for administrative purposes into appropriate departments. Thus, for example, a dealer in leather goods may sub-divide his business into the following departments :—Ladies' Bags, Fancy Goods, Fitted Cases, Suit and Attaché Cases, Dog Equipment, Miscellaneous, etc. Insurance companies are compelled by Statute to departmentalise their activities as between Life, Fire, Accident, Employers' Liability insurance, etc. Departmentalisation is equally applicable to services, e.g. piano-tuning, and the division adopted may be founded upon the areas served, or upon any other convenient basis. It is also adapted to manufacturing businesses, and the principles are the same. The last aspect is further considered in the chapter on Cost Accounting.

For administrative purposes, this sub-division of activities is usually accompanied by a corresponding sub-division of the accounting records, in order that the trading results of each department may be ascertained separately.

Necessity for Sub-Division.—In a business which deals in several commodities, departmental accounts are imperative. Intelligent management cannot otherwise be secured. If the business as a whole shows a profit, that is no indication that some of its departments are not being worked at a loss. Experience amply demonstrates that, in this type of business, departments may be run at a loss for long periods unknown to the management, until the fact is brought to notice through accident, or some outside cause. It is true that, sometimes, a department is *deliberately* conducted at a loss in order to attract customers, but though the loss be intentional, the actual cost of this particular mode of advertisement should be known to the management.

Purchases.—In order to ascertain the trading results of each department, the records must be arranged to facilitate analysis. Usually, it is inconvenient to keep separate purchases ledgers for each department, since any one transaction may be distributed over more than one department. The business will also need a comprehensive survey of its dealings with its creditors. This, however, is no bar to the analysis

DEPARTMENTAL PURCHASES BOOK.

Date.	Invoice No.	Name.	Particulars.	Ledger Folio.	Total.			Department.												Ledger Folio.	Private or Nominal Ledger.		
								A.			B			C.			D.						
					£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.		£	s	d.

of the purchases. Occasionally this analysis is made on the face of the invoices, credit being also given for the discount due to each department on its share of the invoice. This practice is not commendable, and the analysis of the invoices in a properly ruled Departmental Purchases Book is more usual and dependable. If one central store is maintained, the goods will usually be issued to individual departments on the imprest system—similar to the method advocated for keeping the Petty Cash, the issues being analysed in an Issues Day Book. As stated above, the purchases should be recorded in a columnar Departmental Purchases Book, ruled as here shown.

In modern practice, loose sheets are frequently used for this purpose, and afterwards inserted in a binder for safety until the end of the financial period, when they can be removed to transfer cases for storage. The most modern development is to omit all names and particulars, merely referring to the invoice number. Special adding and tabulating machines may be employed to make the analysis. The total column is used for posting to the personal ledgers and for checking the cross casts. The summations of the analysis columns are posted to a columnar purchases account in the Nominal Ledger, with the exception of the "Private or Nominal Ledger" items. The latter consist of "capital" and similar purchases, and are posted in detail to the appropriate accounts. Returns are similarly dealt with.

Sales.—Where customers buy from one department only, it may be practicable for each department to keep its own sales ledgers, but it more usually happens that each

customer's account includes goods from several departments. In such a case, separate ledgers would be impracticable. Moreover, customers generally prefer a combined statement, and the management should know the full extent of each customer's indebtedness. For these reasons, the Sales Ledgers must be centralised in the counting house, and separate Sales Books or Analyses provided. Analysis is generally necessary, as many orders will cover several departments. The necessary analysis may be done either in a Departmental Sales Book, or on loose sheets. Returns inwards must also be suitably analysed in a columnar Departmental Returns Book. The ruling and posting of the Books or Analysis Sheets for departmental sales and returns are similar to those for departmental purchases given above. Cash sales are dissected at the close of each day and recorded in a columnar Departmental Cash Sales Book; from thence they are entered in daily or weekly totals in the General Cash Book and posted to the credit of the respective departments.

Stock.—If stock ledgers are kept, these will be departmentalised, except in respect of goods still in the central store (if any). In any case, stock-taking must be recorded departmentally.

Other Trading Account Debits.—All expenses solely and necessarily incurred in putting goods into saleable condition must be analysed as between the various departments, usually a fairly simple task. *Carriage Inwards* should be attached to the goods on which it is incurred. If a central store is in operation, the issue price can be made to include carriage. *Wages* generally can be definitely charged to the respective departments. *Warehouse Expenses* may have to be apportioned on the turnover of, or the average stock held, or the square feet occupied, or the number of articles sold by, each department, or upon some other equitable basis.

Gross Profit.—Where the accounts are kept on the above basis, departmental trading accounts are easily prepared, and the respective *gross profits* ascertained. In some cases, the separation of results is not carried beyond this point, but in others the whole of the expenses are analysed, and the *net profit* of each department is determined.

Departmental Profit and Loss Accounts.—Only in rare cases are the expenses spread evenly over the departments. For this reason, the gross profits shown may not be indicative of the net results achieved. The class of goods, the position occupied by the department in the store, and similar considerations must be taken into account, and it may well happen that a large gross profit is more than absorbed by office and selling expenses. Departmental Profit and Loss Accounts are, therefore, generally speaking, essential, in order to ensure that not only the business as a whole but that each department is earning an adequate net profit. Further, these accounts facilitate the collection and comparison of results period by period, and often disclose valuable information regarding the ratio of expenses incurred by each depart-

ment, the trend of public taste, seasonal demands, relative working capitals, average yields, etc. The slight additional labour and expense involved in preparing these departmental accounts will almost invariably be more than made good by the additional grip they afford upon the business, revealing as they do where expansion or retrenchment is necessary.

Allocation of Expenses.—Where the expenses are incapable of direct analysis, one or more of the bases mentioned above as applicable for warehouse expenses may be adopted for suitable items of expense, but each item must be judged on its own merits, taking into consideration the circumstances in which it arose. The following general rules are usually applicable :—

(1) *Expenses directly incurred in selling and securing payment for goods should be charged against the departments in proportion to the total sales of each department.*

Office organisation expenses, travellers' commission and expenses, and superintendence and administration charges fall under this heading. *Discounts* also are usually apportioned on this basis, although, strictly speaking, they are more properly apportionable on the basis of the turnover for the periods in which the relative sales were made. If the turnover is fairly constant and the discounts are small, the results will be approximately accurate ; but, in many businesses, the turnover is seasonal, and the " lag " of discount allowances should be taken into account. For example, if three months is allowed for payment, the January sales will be reflected in the April discounts, so that the discounts for the year January 1st to December 31st would be more properly apportioned on the basis of the sales from October 1st to September 30th.

(2) *Expenses directly incurred on behalf of any department should be charged to that department.*

Such expenses may include boxes, packing materials, certain insurances, bad debts, special departmental salaries and commissions, departmental catalogues, samples, etc. *Advertising* can generally be allocated to individual departments, but inasmuch as every advertisement usually includes a general " house " advertisement, the proportion of the space occupied by these general advertisements, which benefit the whole business, should be apportioned over all the departments, e.g. on the basis of sales. *Depreciation* can generally be directly based upon the value of the assets employed in the department. *Insurance*, according to its kind, will be based upon the value of the assets covered, or the wages paid, etc.

(3) *Expenses chargeable against the business generally, for example, Rent, Rates and Taxes, Lighting and Heating, etc., should be apportioned on the basis of (a) Relative effective square feet occupied by the department, or (b) valuation or assessment of the space occupied, or (c) relative average value of the stock held by the department, or*

(*d*) *turnover*, *i.e. relative value of the departmental sales*, *or* (*e*) *number of articles sold.*

Heating, Lighting, and Power may be based on metered consumption, or the number of lamps, or of points wired, or on the wattage of lamps, or on the effective square or cubic feet occupied, or on the number of machines at work, etc., according to circumstances.

The type of business, the character of the stock, the departmental trading methods employed, and, in retail stores, the relative position of the department must also be considered when allocating expenses under this head. A department on the top floor may have a large window assigned to it on the street level, and may have an efficient lift service, both of which counteract its relatively poor position. Departments dealing in bulky stocks of small value cannot be treated in precisely the same way as departments selling small but costly articles. New departments need treatment somewhat different from fully established departments. The aim must be to make each department bear its just, but no more than its just, share of these expenses, and that calls for the exercise of the judicial virtues. Rent, for example, may be based on floor space occupied, but, in some cases, the relative value of the position occupied by the department should also be taken into account.

(4) *Departments may be charged with interest, calculated on the estimated amount of capital that each department employs.*

The capital sum to be charged with interest is found by adding to the average value of the stock held during a trading period, the average value of the outstanding book debts for the period, and then deducting the average liabilities for the period. When determining the average, the number of times the stock is turned over has to be considered.

Credits to Profit and Loss Account.—The character of the credits and the respective claims of the departments determine the allocation of these items. The necessary analyses are usually most conveniently made on loose sheets, unless the departments are so few in number that analysis columns can be provided in the subsidiary books and ledger accounts.

Inter-Departmental Transactions.—Invariably there will occur a number of inter-departmental transfers of goods and/or services. It is quite inaccurate to add these transfers to the sales and purchases of the departments concerned, since both will be unduly inflated, and the results will be useless for purposes of comparison, more so if such transfers are considerable. If the goods are transferred at cost, the credit should certainly not be made to the sales of the transferring department; if the transfer is made at selling price, the debit should not be made to the Purchases Account of the receiving department. Both entries should be made to separate Transfers Accounts. Frequently the transfers are made at a price slightly above cost in order to cover the expense of handling. It is obvious, therefore, that

transfers should be reduced to a minimum. The various Transfers Accounts will be carried in due course to the Departmental Trading Account (debit receiving department; credit issuing department) as separate items in the appropriate department figures, or they will be adjusted in the Purchases Accounts of the departments concerned.

Form of Combined Accounts.—The combined Trading and Profit and Loss Accounts are usually prepared in columnar form, with a column for each department and a total column. The net profits are carried to the General Profit and Loss Account, which usually takes the form of an Appropriation Account. Detailed rulings will be found in *Accounting*, Chapter XVI.

Illustration.—The Trial Balance on p. 570 was extracted as on December 31, 19.., from the books of Dickson Brothers, the two partners being

TRADING AND PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

DR.

	Department A.			Department B.			Department C.			Total.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
To Stock	1,143	16	4	986	14	6	264	12	5	2,395	3	3
" Purchases	3,465	14	1	3,244	1	3	1,411	2	3	8,120	17	7
" Transfers..				120	1	0	30	0	8	150	1	8
" Carriage Inwards	18	0	6	18	0	6	9	0	3	45	1	3
	4,627	10	11	4,368	17	3	1,714	15	7	10,711	3	9
" Balance being Gross Profit carried down	1,734	17	3	1,059	6	0	255	5	0	3,049	8	3
£	6,362	8	2	5,428	3	3	1,970	0	7	13,760	12	0
To Rent, etc.	325	18	7	325	18	7	162	19	4	814	16	6
" Wages and Salaries	256	14	0	256	14	0	128	7	0	641	15	0
" Discounts and Allowances	18	16	10	18	16	10	9	8	5	47	2	1
" Advertising and Catalogues	132	9	9	132	9	10	66	4	11	331	4	6
" Bad Debts	63	19	11	63	19	10	31	19	11	159	19	8
" Addition to Bad Debts Reserve	2	14	3	2	14	2	1	7	1	6	15	6
" Printing and Stationery	27	11	9	27	11	9	13	15	10	68	19	4
" Commission .. .. .. -	44	5	7	44	5	7	22	2	10	110	14	0
" Postages, etc.	37	13	8	37	13	8	18	16	10	94	4	2
" Insurance	12	2	2	12	2	2	6	1	1	30	5	5
" General Expenses	42	6	0	42	6	0	21	3	0	105	15	0
" Depreciation on Furniture	20	0	0	20	0	0	10	0	0	50	0	0
	984	12	6	984	12	5	492	6	3	2,461	11	2
" Balance carried down being Net Profit for the year	750	4	9	74	13	7	*237*	*1*	*3*	587	17	1
£	1,734	17	3	1,059	6	0	255	5	0	3,049	8	3

DR.

		£	s.	d.
To Interest on Capital		250	0	0
" H. Dickson, Share of Profit	£237 13 7			
" G. Dickson, Share of Profit	237 13 6			
		475	7	1
		£725	7	1

equal partners. You are required to prepare Departmental Trading and Profit and Loss Accounts and a Balance Sheet.

When preparing the necessary accounts, make the following provisions as on December 31, 19.. :—

(1) Credit the partners with interest for the year on their Capital Accounts at 5 % per annum. (2) Debit the partners with 5 % on their drawings. (3) Write off bad debts amounting to £159 19s. 8d., and thereafter increase the reserve for doubtful debts to 5 % of the book-debts outstanding. (4) Provide for a stationery account owing at December 31st, estimated to amount to £20. (5) Write 10 % off the furniture and fittings. (6) Of the £40 5s. 5d. paid for Insurance Premiums, £10 relates to the period after December 31st. (7) The value of the Stocks on hand as on December 31st were as follows: Department A, £1,046 4s. 2d.; Department B, £1,000 1s. 3d.; Department C, £493 19s. 11d. (8) A stock of catalogues remains on hand valued at £30, which has not yet been

TRADING AND PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19..—*continued.*

Cr.

	Department A.			Department B.			Department C.			Total.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
By Sales (net)	5,166	2	4	4,428	2	0	1,476	0	8	11,070	5	0
,, Transfers	150	1	8							150	1	8
,, Stock	1,046	4	2	1,000	1	3	493	19	11	2,540	5	4
£	6,362	8	2	5,428	3	3	1,970	0	7	13,760	12	0
By Balance brought down	1,734	17	3	1,059	6	0	255	5	0	3,049	8	3
£	1,734	17	3	1,059	6	0	255	5	0	3,049	8	3

Cr.

	£	s.	d.
By Balance being Net Profit brought down	587	17	1
,, Dividends	120	0	0
,, Interest on Drawings *	17	10	0
	£725	7	1

* Drawings have been assumed to be made equally over the whole year.

adjusted in the books. (9) Inter-departmental transfers were made at cost price. (10) All expenses are to be allocated between the departments in the proportion 2 : 2 : 1.

TRIAL BALANCE, DECEMBER 31, 19...

	Dr. £	s.	d.	Cr. £	s.	d.
Capital Accounts:—						
H. Dickson				3,333	6	8
G. Dickson				1,666	13	4
Drawings:—						
H. Dickson	400	0	0			
G. Dickson	300	0	0			
Stock, January 1st:—						
Department A	1,143	16	4			
Department B	986	14	6			
Department C	264	12	5			
Purchases (Gross):—						
Department A	3,465	14	1			
Department B	3,244	1	3			
Department C	1,411	2	3			
Sales:—						
Department A				5,519	9	5
Department B				4,730	19	6
Department C				1,576	19	10
Inter-departmental Transfers:—						
Department A				150	1	8
Department B	120	1	0			
Department C	30	0	8			
Returns Inwards:—						
Department A	353	7	1			
Department B	302	17	6			
Department C	100	19	2			
Wages and Salaries	641	15	0			
Advertising and Catalogues	361	4	6			
Dividends on Shares in XY Co., Ltd.				120	0	0
Shares in XY Co., Ltd.	2,000	0	0			
Sundry Debtors	895	9	8			
Printing and Stationery	48	19	4			
Sundry Creditors				549	5	2
Carriage Inwards	45	1	3			
Commission	110	14	0			
Postages, Telegrams, and Telephone	94	4	2			
Reserve for Bad and Doubtful Debts (as at January 1st)				30	0	0
Rent, Rates, and Taxes	814	16	6			
Furniture and Fixtures	500	0	0			
Insurance	40	5	5			
General Expenses	105	15	0			
Bank Balance				151	17	7
Discounts and Allowances	47	2	1			
	£17,828	13	2	£17,828	13	2

II. Branch Accounts.

Branches may be described as departments conducted at a distance. We are not here concerned with that more modern extension commonly termed a Holding Company (*see* p. 464) and its subsidiaries, since a subsidiary company has a distinct legal existence, whereas a branch is essentially a part of the business as a whole.

General Principles.—In a general text-book it is not possible or even desirable to attempt to deal with every form of relationship between a Branch and its Parent House, since the exact relationship is determined by the particular needs of the case. All that is attempted here is an explanation of the underlying principles applicable to all cases alike,

Dickson Brothers

BALANCE SHEET, DECEMBER 31, 19...

		£	s	d.	£	s	d
Capital Accounts:—							
H. Dickson		3,333	6	8			
G. Dickson		1,666	13	4	5,000	0	0
Creditors:—							
Trade		549	5	2			
Stationery		20	0	0	569	5	2
Bank Overdraft					151	17	7
Current Accounts:—							
H. Dickson, Interest on Capital	£166 13 4						
Share of Profit ..	237 13 7	404	6	11			
Less Drawings	400 0 0						
Interest on Drawings ..	10 0 0	410	0	0			
To contra		5	13	1			
G. Dickson, Interest on Capital	83 6 8						
Share of Profit ..	237 13 6	321	0	2			
Less Drawings	300 0 0						
Interest on Drawings ..	7 10 0	307	10	0	13	10	2
					£5,734	12	11

		£	s.	d.
Furniture and Fixtures	£500 0 0			
Less Depreciation	50 0 0	450	0	0
Shares in X Y Co., Ltd.		2,000	0	0
Stock		2,540	5	4
Catalogues		30	0	0
Sundry Debtors	£735 10 0			
Less Reserve for Doubtful Debts .. .	36 15 6	698	14	6
Insurance in advance		10	0	0
Current Account, H. Dickson		5	13	1
		£5,734	12	11

which, once they are clearly grasped, can easily be adapted to any set of circumstances.

The simple book-keeping system, adequate for the sole trader, with a single office or shop, is naturally inadequate to a series of establishments controlled by a central management. In multiple concerns, the buying is generally done by the Head Office, and adequate checks on the honesty and efficiency of the Branch management are necessary, if the undertaking is to be controlled effectively.

Requirements of Efficient System.—To be satisfactory, a system of Branch book-keeping should afford :—

(*a*) Facilities for ascertaining at any time the trading results of each branch.

(*b*) Efficient checks on the honesty of the Branch staffs.

(*c*) Prompt information on all matters affecting proper supervision and control.

(*d*) Material for making useful comparisons as between branches and as between trading periods.

Suitable statistical returns must also be devised for dealing periodically with such matters as stock required ; orders in hand ; orders not yet commenced ; special local requirements ; customers' complaints ; stock on hand ; accounts due and overdue ; and so on.

The class of business, the distance of the Branch from the Head Office, the perishability of the stock, the possibility of internal check at the Branch, together with the degree of control which is desirable and possible, determine the accounting methods to be adopted. It is obvious that vastly different methods are necessary for such different businesses as Banking, Insurance, Wholesale Provision Merchants, General Carriers, Retail Merchants, to mention a few only. It is proposed to confine this chapter to retail establishments, since the conduct of retail branches is the most complicated, in view of the fact that in addition to cash, stocks are involved.

Kinds of Branches.—Broadly speaking, branches can be divided into two main classes :—

(*a*) Mere selling agencies, keeping no independent accounts other than those relating to sales and petty disbursements.

(*b*) Branches that keep independent books and record all their transactions.

Class (*a*) chiefly consists of businesses dealing in everyday requirements suitable for sale in all or most districts alike ; class (*b*) embraces all such businesses as deal in goods that are affected by fashion or local custom, and which, for their effective conduct, require that the Branch Managers shall be allowed some discretion in the purchase of goods.

Methods of Invoicing Goods to Branches.—Three methods are employed when invoicing goods sent from Head Office to the Branches, viz. :—

(*a*) At cost price, i.e. in a manufacturing business, at works cost ; in a non-manufacturing concern, at net invoice price.
(*b*) At a definite percentage on cost.
(*c*) At the retail selling price of the goods.

Branch as Agency.—Here the Branch may be but a mere feeder of and collector for its Head Office, which executes all orders. Petty disbursements will be dealt with on the imprest system, the imprest being replenished from Head Office. Orders will be entered in carbon duplicating Order Books, and, if the Branch collects accounts due, a Cash Book will be kept to record amounts paid by customers. Head Office will forward periodically to the Branch a schedule of all amounts outstanding. This, frequently, takes the form of carbon copies of the invoices, which can be marked off when paid. Cash received must be banked intact daily, or as often as the branch bank is open. If coin is required for change, a cash " float " should be instituted. Regular periodical returns, usually bi-weekly or weekly, should be sent to the Head Office by the Branch Manager.

Branch as Independent Trader.—A Branch trading independently will execute its own orders, wholly or partly from stock obtained from the Head Office. It may be allowed to make direct purchases, and may collect, and be answerable for, its own book debts, and be allowed to keep a separate banking account and discharge its own liabilities. In such cases, periodical returns and remittances will be made to the Head Office. Stock sent from the Head Office will, in these circumstances, usually be invoiced at cost, or with a slight addition for handling.

The Branch frequently, however, is not allowed to make any purchases or any disbursements other than petty expenses. All stock is supplied from Head Office, the Branch making the sales. In such cases, the Branch may be allowed to keep its own Sales Ledgers and collect amounts due, or this work may be done by the Head Office. In the latter case, copies of all invoices must be forwarded to the Head Office with the bi-weekly or weekly reports. In either case, all cash takings must be banked or remitted direct to the Head Office intact. The Branch will credit Head Office Account with stock and cash received, and debit it with remittances and any returns, discounts, and allowances. Where the Head Office collects the debts, separate branch day books or summaries of invoices, and separate sales ledgers, and cash columns will be instituted.

Central District Depôts.—In a concern with branches widely scattered, it may be necessary to have central warehouses at convenient centres, so that goods may be distributed quickly. In such cases, it may also be convenient to have the accounting centralised at these

depôts. Each depôt will then be similar to an independent branch keeping its own books, and possibly making its own purchases, the Trial Balance of the depôt being incorporated in the Head Office records periodically. The Branches would be accountable to the depôt in the same way as, in smaller concerns, they are accountable direct to the Head Office.

Where the Head Office makes all Purchases.—The remarks made above on departmental transfers are even more applicable to branch transfers. Head Office may be simply a Warehouse and Counting House, or it may run a selling establishment in addition. In the latter case, it is desirable to separate the expenses and accounting of the two sides of the business, since the buying and warehousing expenses are applicable to all branches. The buying and warehousing expenses must, therefore, be charged out to all the branches on an equitable basis, e.g. turnover, or, what amounts to much the same thing, by means of a percentage or flat addition to the cost price.

In order adequately to show the accounting methods usually employed, examples and explanations of the working of the more common methods are appended. A Head Office and one or two Branches will be taken, as occasion demands. Head Office is referred to throughout as "H.O."

Illustration 1.—*Branch as agency, collecting orders which are executed from Head Office.*

The Branch collects sums due, and banks receipts intact weekly. Petty expenses are met by an Imprest, and a "float" of £5 is kept at the Branch to provide small change.

Opening position :—

	£	£
H.O. Books :—		
Capital		3,215
Creditors		800
Sundry Assets	1,200	
Stock	900	
Debtors	800	
Cash	100	
Branch Assets	600	
Branch Debtors	400	
Branch Float	5	
Branch Petty Cash	10	
	£4,015	£4,015

The transactions for the four weeks ended January 28, 19.., were as follows :—Orders received from Branch and executed, £500; Cash received by Branch, £550; Cash banked by Branch, £500; Purchases, £600; H.O. Sales (all credit), £900; Cost Price of goods invoiced on behalf of Branch (net), £300; Closing Stock, £740; H.O. Receipts from Debtors, £1,200; Discount allowed H.O., £11; Discount allowed Branch, £5; Discount received H.O., £20; Returns Inwards, Branch, £10; Returns Outwards, H.O., £6; H.O. Payments to Creditors, £1,000; Cheque sent by H.O. to reimburse Branch Petty Cash, £8; Expenses (including salaries, etc.), H.O., £145; Expenses paid by H.O. in respect of Branch, £50. Show the Ledger Accounts in H.O. Books, and prepare interim accounts, ignoring outstandings.

LEDGER.

Capital Account.

Dr. | Cr.

Date	Particulars		£	s.	d.	Date	Particulars		£	s.	d.
						19.. Jan. 1	By Balance		3,215	0	0

Creditors.*

Dr. | Cr.

Date	Particulars		£	s.	d.	Date	Particulars		£	s.	d.
19... Jan. 28	To Returns		6	0	0	19.. Jan. 1	By Balance		800	0	0
,, 28	,, Cash		1,000	0	0	,, 1	,, Purchases		600	0	0
,, 28	,, Discount		20	0	0						

Sundry Assets.*

Dr. | Cr.

Date	Particulars		H.O. £	s.	d.	Branch. £	s.	d.	Date	Particulars		H.O. £	s.	d.	Branch. £	s.	d.
19... Jan. 1	To Balance		1,200	0	0	600	0	0									

Stock.

Dr. | Cr.

Date	Particulars		£	s.	d.	Date	Particulars		£	s.	d.
19 .. Jan. 1	To Balance		900	0	0						

Debtors.*

Dr. | Cr.

Date	Particulars		H.O. £	s.	d.	Branch. £	s.	d.	Date	Particulars		H.O. £	s.	d.	Branch. £	s.	d.
19... Jan. 1	To Balance		800	0	0	400	0	0	19 .. Jan. 28	By Branch					555	0	0
,, 31	,, Sales		900	0	0	500	0	0	,, 28	,, Cash and Discount		1,211	0	0			
									,, 28	,, Returns					10	0	0

* In practice, separate accounts for each creditor, asset, and debtor would be opened.

LEDGER—*continued.*

CASH BOOK.

Dr.			Discount. £	s.	d.	£	s.	d.				Discount. £	s.	d.	£	s.	d. Cr.
19... Jan. 1	To Balance					100	0	0	19... Jan. 28	By Creditors		20	0	0	1,000	0	0
" 28	" Branch					500	0	0	" 28	" Branch:—							
" 28	" Debtors		11	0	0	1,200	0	0		Petty Cash					8	0	0
										General Expenses					50	0	0
									" 28	" H.O. Expenses					145	0	0

Branch Change Float.

Dr.			£	s.	d.				£	s.	d. Cr.
19... Jan. 1	To Balance		5	0	0						

Branch Petty Cash.

Dr.			£	s.	d.				£	s.	d. Cr.
19... Jan. 1	To Balance		10	0	0						

Branch Account.

Dr.			£	s.	d.				£	s.	d. Cr.
19... Jan. 1	To Cash received from Debtors		550	0	0						

LEDGER—*continued.*

PURCHASES.

Dr.											Cr.
			£	s.	d.				£	s.	d.
19... Jan. 28	To Purchases Book Total		600	0	0	19... Jan. 28	By Returns		6	0	0

SALES.

Dr.																			Cr.
			H.O			Branch.						H.O.			Branch.		
			£	s.	d.	£	s.	d.				£	s.	d.	£	s	d.
19... Jan. 28	To Returns..					10	0	0	19... Jan. 28	By Sales Book		900	0	0	500	0	0

REMITTANCES FROM BRANCH.

Dr.											Cr.
			£	s.	d.				£	s.	d.
						19... Jan. 28	By Cash		500	0	0

DISCOUNT.

Dr.																	Cr.
			H.O.			Branch.						H.O.			Branch.		
			£	s.	d	£	s.	d.				£	s.	d	£	s.	d.
19... Jan. 28	To Branch					5	0	0	19... Jan. 28	By Cash Book		20	0	0			
,, 28	,, Cash Book		11	0	0												

EXPENSES.

Dr.																	Cr
			H O.			Branch											
			£	s.	d.	£	s	d				£	s.	d.	£	s.	d.
19... Jan 28	To Cash		145	0	0	58	0	0									

INTERIM TRADING AND PROFIT AND LOSS ACCOUNT FOR THE FOUR WEEKS ENDED JAN. 28, 19...

DR.	H O. £	s.	d.	Branch. £	s.	d.	CR.	H.O. £	s.	d.	Branch. £	s.	d.
To Stock	900	0	0				By Sales (net)	900	0	0	490	0	0
,, Purchases (net)	294	0	0	300	0	0	,, Stock..	740	0	0			
,, Gross Profit carried down..	446	0	0	190	0	0							
	£1,640	0	0	£490	0	0		£1,640	0	0	£490	0	0
To General Expenses	145	0	0	58	0	0	By Gross Profit brought down	446	0	0	190	0	0
,, Discounts	11	0	0	5	0	0	,, Discounts	20	0	0			
,, Net Profit	310	0	0	127	0	0							
	£466	0	0	£190	0	0		£466	0	0	£190	0	0

BALANCE SHEET, JANUARY 28, 19...

	£	s.	d.					£	s.	d.
Capital	3,215	0	0	Sundry Assets:—						
Creditors	374	0	0	H.O.	£1,200	0	0			
Profit and Loss Account	437	0	0	Branch	600	0	0	1,800	0	0
				Stock				740	0	0
				Debtors:—						
				H.O.	£489	0	0			
				Branch	335	0	0	824	0	0
				Cash at Bank				597	0	0
				Cash at Branch				65	0	0
	£4,026	0	0					£4,026	0	0

Illustration 2.—The Branch keeps its own books, and forwards a Trial Balance for incorporation in the H.O. books.

(*a*) *Where the Branch makes its own purchases, no goods being invoiced from H.O.*

In this case, the Trading and Profit and Loss Account of the Branch is prepared separately (not as part of the H.O. double entry), and the net profit is credited to the General Profit and Loss Account, and debited to the Branch Account in the H.O. books. In the Branch books, Trading and Profit and Loss Account is prepared in the usual way, the net profit being credited to H.O. Account. Any income or expenditure on behalf of the Branch which appears only in the H.O. books must be mutually adjusted through the H.O. and the Branch Accounts prior to the preparation of the Profit and Loss Account. It is important to remember that the H.O. Account in the Branch books is, in effect, the Capital Account of the Branch, and that the Branch Account in the H.O. books represents the H.O. Investment in the Branch. When preparing the combined Balance Sheet, these two internal accounts, being reciprocal, naturally cancel each other, the Branch Account in the H.O. books being replaced in the combined Balance Sheet by the assets and liabilities of which it is composed.

(*b*) *Where goods are supplied from H.O. at cost.*

In this case, the goods sent by H.O. are debited to the Branch Account as and when sent, and credited to a " Goods sent to Branch Account," which is closed by transfer to the credit either of H.O. Trading Account or of Purchases Account. Otherwise the entries are as in (*a*). The Branch debits Purchases Account and credits H.O. with the goods as received; H.O. Account thus takes the place of the Creditors' Personal Accounts.

An approximate check can be imposed by adding the average gross profit realised on each class of goods to the cost price of the goods sold, but this check is only practical where the gross profit is a fixed percentage of the selling price, and the classes of goods sold do not vary greatly.

Illustration 3.—Where all goods are supplied by H.O., the Branch keeping its own Sales Ledgers and appropriate Sales Books and Cash Books, remitting cash to H.O. daily.

In this case it is usual for the Branch to send full returns at least once in every four weeks. The H.O. controls the Branch debtors by means of Total Accounts, which form part of the double entry. Goods sent to the Branch are debited to the Branch Transfers Account, and credited to " Goods sent to Branch Account." From the periodical returns, Branch Debtors Account is debited, and Sales Account credited, with the total net credit sales for the period; Branch Account is debited, and Branch Debtors Account credited with the total cash received from debtors; Branch Discounts and Allowances Accounts are debited, and Branch Debtors Account credited with the discounts, etc., allowed to the Branch debtors. If the Branch is permitted to meet its expenses out of receipts, the appropriate Branch Expense Accounts are debited, and Branch Account is credited. Remittances from the Branch are credited to Branch Account, and debited to Cash.

This method is similar to method (2), with the exception that the H.O. books, through the incorporation of the Branch Returns, contain all the information necessary for the preparation of the final accounts, with the exception, of course, of the closing stock, which is dealt with in the usual manner.

Stock at Loaded Prices.—So far, the entries for supplies of stock have been dealt with at cost prices. But, as already mentioned, it may be desirable and more convenient to invoice the goods sent to a Branch at a price exceeding cost, or at the selling price for such goods, in order (*a*) to keep a check upon the Branch, and (*b*) to prevent the branch staff from learning the exact profit upon sales, and how it is made up. Where selling price is adopted for invoicing, the Branch manager has always to account for the goods received either in cash or stock in hand, because, as is clear, the stock in hand should always equal the initial stock *plus* purchases *less* sales. An effective check is thus established. Variations in price are dealt with by additional charges or allowances made to the Branch. Almost invariably, however, there will be a margin of error in the closing stock due to loss in issuing small quantities, spoilage, errors of price, damaged stock, and other causes. But experience will permit a limit to be placed upon this margin, and, if the limit is exceeded, immediate investigation should follow.

The adjustments in the H.O. books made necessary by invoicing goods to Branches in excess of cost are dealt with as follows :—

(*a*) *Goods invoiced at Selling Prices.*—On January 1, 19.., goods costing £5,000 are invoiced to a Branch and charged up at a selling price designed to produce a gross profit of 33⅓ %. The Branch report on January 28th following shows that the cash sales were £3,000, and the credit sales £3,300. Also that goods invoiced at £60 have been returned to H.O., and the closing stock is £1,128. Record these transactions.

BRANCH GOODS ACCOUNT.

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Jan. 1	To Sundries		7,500	0	0	19... Jan. 28	By Sales		6,300	0	0
							,, Returns		60	0	0
							,, Stock carried down		1,128	0	0
							,, Adjustment Account, loss in Stock		12	0	0
		£	7,500	0	0			£	7,500	0	0
19... Jan. 29	To Stock brought down		1,128	0	0						

GOODS SENT TO BRANCH ACCOUNT.

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Jan. 28	To Returns..		40	0	0	19... Jan. 1	By Branch		5,000	0	0

BRANCH ADJUSTMENT ACCOUNT.

Dr. Cr.

Date	Particulars	£	s.	d.	Date	Particulars	£	s.	d.
19... Jan. 28	To Branch (33⅓ % on £60)	20	0	0	19... Jan. 1	By Branch (33⅓ % on £7,500)	2,500	0	0
	,, Branch Loss ..	12	0	0					
	,, Balance (33⅓ % on £1,128)	376	0	0					
	,, Gross Profit carried to Profit and Loss Account	2,092	0	0					
	£	2,500	0	0		£	2,500	0	0
					19... Jan. 29	By Balance brought down	376	0	0

Another method sometimes adopted for the Branch Account, where goods are transferred at retail selling prices, is shown as under :—

The Universal Tobacco Stores, Ltd., opened a branch shop in Tokenhouse Yard, London, E.C., and debited all supplies at selling price. Goods were supplied as follows: June 1st, £402 16s. 9d.; June 13th, £84 2s. 2d.; June 20th, £117 18s. 9d.; June 27th, £212 14s. 6d. The Branch forwarded to the Head Office the following cash takings: June 8th, £72 4s. 8d.; June 15th, £81 2s. 2d.; June 22nd, £114 6s. 2d.; June 30th, £105 14s. 9d. The Branch retained £20 in cash on June 30th, and paid £15 for expenses out of that week's takings. Show the accounts in the Head Office books as on June 30th, assuming that stock on hand at the Branch (value, at selling price, £409 4s. 5d.) cost £302 1s. 9d.

HEAD OFFICE BOOKS

BRANCH ACCOUNT.

Dr. Cr.

Date	Particulars	£	s.	d.	Date	Particulars	£	s.	d.
19... June 1	*To Goods at Selling Price*	402	16	9	19... June 8	*By Cash from Branch* ..	72	4	8
,, 13	,, Goods at Selling Price	84	2	2	,, 15	,, Cash from Branch ..	81	2	2
,, 20	,, Goods at Selling Price	117	18	9	,, 22	,, Cash from Branch ..	114	6	2
,, 27	,, Goods at Selling Price	212	14	6	,, 30	,, Cash from Branch ..	105	14	9
					,, 30	,, Expenses paid at Branch	15	0	0
					,, 30	,, Balance carried down: Stock on hand valued at selling price ..	409	4	5
						Cash in hand at Branch	20	0	0
		£817	12	2			£817	12	2
19... July 1	To Balance brought down:— Stock on hand at selling price	409	4	5					
	Cash in hand at Branch	20	0	0					

GOODS SENT TO BRANCH.

Dr.		£	s.	d.	Cr.		£	s.	d.
19... June 30	To Transfer to H.O. Combined Trading Account, being Branch Sales for the month	408	7	9	19... June30	By Total Goods sent to Branch, valued at selling price	817	12	2
,, 30	,, Stock on hand at Branch, valued at selling price, carried down	409	4	5					
		£817	12	2			£817	12	2
					19... June30	By Stock on hand at Branch, valued at selling price, brought down	409	4	5

COMBINED TRADING ACCOUNT.

(Head Office and Branch.)

Dr.		£	s.	d.	Cr.		£	s.	d.
					19... June30	By Branch Sales, Tokenhouse Yard..	408	7	9
					,, 30	,, Stock on hand at Branch, valued at cost	302	1	9

COMBINED PROFIT AND LOSS ACCOUNT.

(Head Office and Branch.)

Dr.		£	s.	d.	Cr.		£	s.	d.
19 .. June 30	To Branch Expenses, Tokenhouse Yard .. .	15	0	0					

The Stock in hand is carried down in the Branch Account and in the Goods sent to Branch Account at selling price. The balance of the Goods sent to Branch Account therefore represents the sale price of the goods sold, and can be transferred to General Trading Account. The carrying down of the unsold stock at selling prices in the Goods sent to Branch Account neutralises the bringing down of the same item on the opposite side of the Branch Account. The stock in hand at the Branch can be brought into the combined Trading Account at cost, in the manner ordinarily employed in Trading Accounts. Any difference in the closing stock must be adjusted in the Branch, and Goods sent to Branch Accounts, in order that the exact Balance in Hand may be carried down. Advantages claimed for invoicing goods to Branches at selling prices are: (*a*) the cost price of goods is not disclosed, and (*b*) the system affords a simple check upon the manager,

who has to account for his initial stock plus purchases less sales and final stock.

(*b*) *Goods issued at a Percentage above Cost.*—On January 1st, goods costing £5,000 are invoiced to a Branch at 20 % above cost. The Branch report on January 28th shows that the cash sales amounted to £3,000, credit sales to £3,300, and cash received from debtors to £2,300. Goods invoiced at £60 had been returned by the Branch to H.O. The closing stock at the Branch amounted to £900 at invoice prices. Show the records of these transactions, assuming that all cash has been remitted to H.O. as received.

BRANCH GOODS ACCOUNT.

Dr.									Cr.
19...		£	s.	d.	19...		£	s.	d.
Jan. 1	To Sundries	6,000	0	0	Jan 28	By Cash	3,000	0	0
	„ Balance, being apparent gross profit	1,260	0	0	„ 28	„ Debtors	3,300	0	0
					„ 28	„ Returns	60	0	0
					„ 28	„ Stock carried down	900	0	0
		£ 7,260	0	0			£ 7,260	0	0
19... Jan. 29	To Stock brought down	900	0	0					

GOODS SENT TO BRANCH ACCOUNT.

Dr									Cr.
19...		£	s.	d.	19...		£	s.	d.
Jan. 28	To Returns.. .. .	50	0	0	Jan. 1	By Branch	5,000	0	0

BRANCH ADJUSTMENT ACCOUNT.

Dr.									Cr.
19..		£	s.	d.	19...		£	s.	d.
Jan. 28	To Returns (20 % on £50)	10	0	0	Jan. 1	By Branch (20 % on £5,000)	1,000	0	0
„ 28	„ Balance carried down ($16\frac{2}{3}$ % on £900)	150	0	0	„ 1	„ Apparent Gross Profit	1,260	0	0
„ 28	„ Profit and Loss Account being Gross Profit	2,100	0	0					
		£ 2,260	0	0			£ 2,260	0	0

CASH ACCOUNT.

Dr.									Cr.
19...		£	s.	d			£	s.	d.
Jan. 28	To Cash Sales	3,000	0	0					
„ 28	„ Debtors	2,300	0	0					

BRANCH DEBTORS' ACCOUNT.

Dr.			£	s.	d.				£	s.	d. Cr.
19.. Jan. 28	To Sales		3,300	0	0	19.. Jan. 28	By Cash		2,300	0	0
						" 28	" Balance carried down		1,000	0	0
		£	3,300	0	0			£	3,300	0	0
19.. Jan. 29	To Balance brought down		1,000	0	0						

Confusion sometimes arises in examination work in determining the percentage to be eliminated from closing stock in order to reduce it to cost under the systems outlined above. A little reflection should make it clear that when a percentage has been added to cost, the *same* percentage deducted from the increased amount will not reduce it to cost. If £100 is taken as cost, and 25 % is added thereto, the amount becomes £125. The proportion to be deducted in order to reduce the amounts to cost is, therefore, $\frac{25}{125}$, i.e. $\frac{1}{4}$th has been added to the cost, therefore $\frac{1}{5}$th must be taken away from the selling price. Students should also carefully note whether the percentage is calculated on cost or on selling price.

Double Column Branch Accounts.—In order to avoid use of a Branch Adjustment Account, the Branch Goods Account may be ruled with double columns, the inner column being used as a memorandum column to record the invoice price and to control the goods, the outer column being, in effect, the Trading Account of the Branch. Applying this method to the examples on pp. 580 and 583, the records are as on p. 585.

Goods sent to Branch Account must be closed off to the credit of Trading Account or Purchases Account in the H.O. books in order to show the true result of the H.O. trading.

The "One Account" System.—A method sometimes adopted is to combine all the Branch transactions in one account, which includes all stock, sales, debtors, etc. An example is appended :—

	£
Goods invoiced at cost to Branch	48,400
Returns to H.O.	100
Stock, January 1st	6,000
Cash Sales	12,000
Credit Sales for the year	45,800
Allowance to customers	50
Discounts allowed to customers	110
Bad Debts	40
Rent, Rates, and Taxes	500
Returns from customers	200
Wages and Salaries	800
Debtors, January 1st	5,500
Stock, December 31st	8,500
Sundry Expenses	1,100
Cash received on Ledger Accounts	44,900
Debtors, December 31st	6,000

Example (a)

BRANCH GOODS ACCOUNT.

Dr. — Invoice Price. — Invoice Price. — Cr.

Date	Particulars	Invoice £	s.	d.	£	s.	d.	Date	Particulars	Invoice £	s.	d.	£	s.	d.
19... Jan. 1	To Sundries	7,500	0	0	5,000	0	0	19... Jan. 28	By Sales	6,300	0	0	6,300	0	0
,, 28	,, Gross Profit				2,092	0	0	,, 28	,, Returns	60	0	0	40	0	0
								,, 28	,, Stock carried down	1,128	0	0	752	0	0
								,, 28	,, Apparent Loss	12	0	0			
		£7,500	0	0	£7,092	0	0			£7,500	0	0	£7,092	0	0
19... Jan. 29	To Stock brought down	1,128	0	0	752	0	0								

GOODS SENT TO BRANCH ACCOUNT.

Dr. — Cr.

Date	Particulars	£	s.	d.	£	s.	d.	Date	Particulars	£	s.	d.	£	s.	d.
19... Jan. 28	To Returns				40	0	0	19... Jan. 1	By Branch				5,000	0	0

Example (b).

BRANCH GOODS ACCOUNT.

Dr. — Cr.

Date	Particulars	£	s.	d.	£	s.	d.	Date	Particulars	£	s.	d.	£	s.	d.
19... Jan. 1	To Sundries	6,000	0	0	5,000	0	0	19... Jan. 28	By Sales	6,300	0	0	6,300	0	0
,, 28	,, Gross Profit	1,260	0	0	2,100	0	0	,, 28	,, Returns	60	0	0	50	0	0
								,, 28	,, Stock carried down	900	0	0	750	0	0
		£7,260	0	0	£7,100	0	0			£7,260	0	0	£7,100	0	0
19.. Jan. 29	To Stock brought down	900	0	0	750	0	0								

GOODS SENT TO BRANCH ACCOUNT.

Dr. — Cr

Date	Particulars	£	s.	d.	£	s.	d.	Date	Particulars	£	s.	d.	£	s.	d.
19... Jan. 28	To Returns				50	0	0	19... Jan 1	By Branch				5,000	0	0

BRANCH ACCOUNT (ON A CASH BASIS).

DR. CR.

		£	s.	d.			£	s.	d.
19... Jan. 1	To Balance :—				19... Dec. 31	By Cash :—			
	Stock	6,000	0	0		From Debtors ..	44,900	0	0
	Debtors	5,500	0	0		Cash Sales	12,000	0	0
Dec. 31	„ Goods from H.O. ..	48,400	0	0	„ 31	„ Returns to H.O. ..	100	0	0
„ 31	„ Rent, Rates, and Taxes	500	0	0	„ 31	„ Balance carried down.			
„ 31	„ Wages and Salaries..	800	0	0		Stock .. £8,500			
„ 31	„ Sundry Expenses ..	1,100	0	0		Debtors 6,000			
„ 31	„ Profit and Loss Account, net profit ..	9,200	0	0			14,500	0	0
	£	71,500	0	0		£	71,500	0	0
19... Jan. 1	To Balance brought down	14,500	0	0					

It will be seen that the above account is simply a combination of all the accounts which in former examples were shown under separate headings. The disadvantages of this method are also apparent, as the H.O. cannot arrive at the true facts of the trading without a great deal of analysis.

Suspense Account.—Where the Branch keeps records of goods, etc., passing between it and H.O., the Branch Account in the H.O. books and the H.O. Account in the Branch books should agree. But when the H.O. and Branch are far apart there is usually, at balancing times, a residuum of entries initiated by the one and not responded to by the other, e.g. goods or cash sent by the H.O. but not, at balancing time, received by the Branch. The statements passing between the offices at balancing times should be promptly checked against the reciprocal ledger accounts, and all items unresponded to should be transferred to a Suspense Account in the H.O. books for items in transit. The Branch Accounts will then show like balances, and the combination of the trial balances may be proceeded with. After balancing, the suspense items can be retransferred to the Branch Account. An alternative method of treatment is to carry down the items in transit as a balance on the Branch Account itself.

When preparing the final accounts, items in suspense should be included in the General Balance Sheet under their proper headings. Thus goods in transit should be included in the General Balance sheet as " Stock." Vague headings, such as " Items in Transit," should be avoided.

Inter-Branch Accounts.—Large undertakings with Branches in all parts of the world may require inter-Branch Accounts, thereby complicating the preparation of the combined Balance Sheet, but the principles remain the same. It is the rule in some businesses for the Branches to settle inter-Branch transactions through the H.O., thereby avoiding the necessity for inter-Branch Current Accounts. Each Branch credits H.O. with all goods or remittances received from any other Branch, and debits H.O. with all goods or remittances sent to any other Branch.

Rules for Reconciling Branch Current Accounts.—The difficulty sometimes experienced in reconciling the accounts of a Branch remote from the H.O. is reduced if definite arrangements are made to facilitate the process.

It should be clearly understood, for example, which office is to render statements to the other, and which is to check and reconcile them. It ought, too, to be the rule that complete advices of all entries should be promptly forwarded by the originating house, and equally promptly responded to by the recipients, whether actually terminated on receipt of the advice or not. A Reconciliation Statement should be prepared at periodical intervals, the process following much the same lines as that adopted when reconciling the Cash and Bank Pass Books. The statement rendered, say by the Branch, is checked against the Branch Account in the Head Office books, and all items in transit in either direction are collected and totalled. The statement may work backwards or forwards in point of date; the essential thing is that the balances should be proved to agree.

Duplicate Branch Ledger.—Though it is true that by means of the reciprocal Adjustment Accounts the Branch books may be kept at any desired place, it is occasionally found that, even when a Branch is allowed to keep its own books, the Head Office prefers to duplicate the Branch books in its own counting house for purposes of discipline and control. This involves the despatch, by the Branch to the Head Office, of complete copies of the Branch Cash Accounts and Journal entries. The Branch Ledger, when written up by the Head Office from these sources, is chiefly of a memorandum nature. If the Branch entries are very numerous, the keeping of a duplicate ledger is impracticable, and, even when it is possible, the practice is liable to break down, owing to the Branch failing to supply complete details. At the best, this method of control involves a great deal of labour, and for this reason it is seldom resorted to, except as a means of supervision in an emergency, or when the book-keeping capacity of the staff is not of a high order.

On p. 592 an illustration is given of a set of Head Office and Branch Accounts. Each Branch kept its own Sales Records, etc., forwarding reports to Head Office every four weeks, and these have been combined with the Head Office accounts in the manner shown, after the inter-house accounts have been eliminated.

Multiple Shop Concerns.

In multiple shop companies, the Branch trade is usually almost wholly a cash trade, and the commodities, e.g. drugs, tobacco, boots, etc., are saleable at fixed prices. Concentration of buying and distribution generally effects economy, and, where possible, it is usual to stock multiple shops from a central warehouse, but district centres may be necessary where perishable goods form the stock-in-trade.

The Check System.—In these circumstances, an excellent check can be imposed upon the Branch by invoicing the goods supplied to the Branch at selling prices, so that the Branch is always accountable for a definite amount in cash, book debts, or unsold stock or a combination of the three. If the check afforded by this arrangement is efficiently applied, leakage due to fraud or mismanagement is readily detected. To yield the maximum benefit, this method must be supplemented by independent stock-taking, at uncertain and unheralded intervals, by a travelling inspector and his staff. Frequently a weekly Stock Return is sent by the Branch to H.O.

In many instances, the Branch stocks are kept on the imprest system, whereby a fixed amount of goods is kept at the Branch, and weekly returns (bi-weekly or every other day in the case of perishable goods) are made to H.O., which replenishes the stock of the Branch to replace the actual sales made. Stock-taking is thus greatly facilitated.

Method of Accounting.—Whether the accounts are kept by one central office or by various district offices, the method is the same. The entries are initiated by the Branch manager's weekly returns of sales, disbursements, goods received from the H.O., and the weekly stock requisition note. A Weekly Return and a Stock Requisition are illustrated on p. 589. The latter is in triplicate. One copy is retained by the Branch manager, another is filed at the central warehouse as an order, and the third is returned as an invoice for the goods sent to the Branch. The H.O. debits the Branch Account in the H.O. books with the total value of the goods at selling prices, and the Branch registers itself either in its Ledger or Stock Book as responsible for the same value. If the Branch is permitted to sell damaged or out-of-date stock at less than the original selling price, a credit note should be sent by the H.O. to adjust the Branch books. Returns should be treated in the same way. Occasionally a " Branch Supplies Journal " is kept, wherein supplies to Branches are entered at both cost and selling prices, accommodation for both particulars being provided in the Branch Account in the Ledger. This form of Journal is illustrated at p. 590.

Cash Sales.—In retail Branches cash sales are the rule and credit sales the exception. In order to keep a check upon cash sales, each shop assistant is given an official number and a carbon check book. These check books, containing from 50 to 100 numbered check forms in duplicate, are kept under lock and key ; and, when issuing them, the manager dates and initials them and records their issue in a Checks Issued Book. The usual form of check is too well known to need illustration. It is used as a kind of invoice to record details of a sale, and, to ensure accuracy, it is usually initialled by a shop-walker or fellow assistant before being handed to the customer. The check book is provided with an index, which is written up by the assistant as the sales are made, and totalled at the end of the day. The system

Branch ....

Dr WEEKLY RETURN FOR THE WEEK ENDING ...., 19...

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
To Cash Sales—							By Cash paid to Bank—						
Monday							Monday..						
Tuesday							Tuesday						
Wednesday..							Wednesday						
Thursday							Thursday						
Friday							Friday						
Saturday							Saturday						
" Cash from Head Office							" Wages						
" Other receipts							" Incidentals						
" *Stock received during week* £.... as per advice note No.							" Travelling..						
" *Stock in hand* £.... as per schedule herewith							" Postage, etc.						
" *Stock required* £.... as per requisition sheet herewith . ..							" Balance in hand						

Branch ....

GOODS REQUIRED BY ...., 19...

Quantities.	Particulars of Goods.	Cost.				Selling.			
		Price per Article.	Amount.			Price per Article.	Amount.		
			£	s.	d.		£	s.	d.

NOTE.—Selling prices only are filled in by the local manager, cost prices being unknown to him; and only selling prices appear in the copy returned with the goods. The copy filed at the central warehouse contains both cost and selling prices.

BRANCH SUPPLIES JOURNAL.

WEEK ENDING JULY 31, 19...

Date.	No. of Invoice	Branch.	Cost Prices.						Goods at Selling Prices.			
			Goods.				Packing Materials.	Trade Expenses.	Folio.	Debits.	Credits.	Net Debit.
			Folio.	Debits.	Credits, Returns, etc.	Net Debit.						
				£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.		£ s. d.	£ s. d.	£ s. d.

is similar to that in general use by the majority of up-to-date concerns doing a cash trade, whether conducted by Multiple Shop organisations or by sole traders.

Depreciation of Assets.—Depreciation necessarily written off any fixed assets which belong to a Branch is frequently dealt with in the H.O. Depreciation Account only; in other cases, it is charged against the particular Branch. If the assets are recorded only in the H.O. books, under the latter system, the adjustment must be made through the Current Accounts.

Warehouse Expenses.—As already mentioned, a percentage may be added to the cost price of the goods to cover warehouse expenses. Frequently, however, this is not practicable; and it is then necessary to apportion them over the Branches, usually on the basis of turnover, taking into account, of course, the nature of the goods. A Grocery establishment may have one Branch running a Bakery from which other Branches are supplied. A Branch may run a tea-shop in addition to the Grocery and Bakery business. Another Branch may run a Bacon-curing Factory, supplying the other Branches. In such cases, the inter-Branch transfers should be at wholesale prices, otherwise the Bakery and Bacon-curing factory will be seriously prejudiced. Moreover, all inter-Branch transfers should be accounted for through the H.O. in order to keep track of the transactions, and minimise disputes.

Minor Complications.—In small country towns and villages, the check on the Branch manager is rendered much more difficult than in larger shops where several assistants are employed. The manager may be alone, or have one or two young girls as assistants. He frequently lives on the premises, and may also be the local postmaster—all circumstances which render the check on the cash more difficult. It is imperative in such cases to keep stocks as low as possible, in order to keep a check on the goods consumed by the manager's household. Where the Branch Bank is only open once or twice a week, customers frequently make use of the shop to cash cheques. Whilst this should be discouraged and reduced to a minimum, maintenance of good will renders it impossible to stop the practice altogether. Records of the cheques so cashed should be kept so that the bankings can be agreed.

Final Accounts.—The Final Trading, and Profit and Loss Accounts, and Balance Sheet, can be prepared in columnar form with total columns, although it is usually unnecessary to show the Balance Sheet in this form.

Illustration.—Uprichards, Ltd., is a retail grocery business, with a Head Office (divided into Warehouse and Selling Departments) and three Branches. All purchases are made by Head Office, and transfers are made at selling price to the branches. Some of the goods are delivered direct to the branches, but all invoices pass through H.O. only. Branch A, in addition to the grocery business, runs a bakery from which the other branches are supplied. Each branch keeps its own Sales Books, Cash

The Trial Balance at January 1st was as follows :—

	Dr. £	s.	d.	Cr. £	s.	d.
Share Capital				100,000	0	0
Sundry Creditors (Trade)				25,000	0	0
Profit and Loss Account				8,000	0	0
Commission Accounts :—						
Branch A				300	0	0
Branch B				200	0	0
Branch C				200	0	0
Managing Director				1,000	0	0
Buyer				250	0	0
H.O. Manager				350	0	0
Freehold Land and Buildings :—						
Head Office	10,000	0	0			
Branch A	8,000	0	0			
Leasehold Land and Buildings :—						
Branch B	5,000	0	0			
Branch C	6,000	0	0			
Goodwill (H.O., at cost)	15,000	0	0			
Motor Vans, etc. (H.O.)	1,500	0	0			
Trade Fittings, Utensils, etc. :—						
Head Office	400	0	0			
Branch A	300	0	0			
Branch B	300	0	0			
Branch C	200	0	0			
Horses, Carts, and Harness (H.O.)	400	0	0			
Sundry Debtors (Trade) :—						
Head Office	4,500	0	0			
Branch A	2,600	0	0			
Branch B	2,700	0	0			
Branch C	3,600	0	0			
Unexpired Insurances, Rates, etc. (expire March 31st) :—						
Head Office	100	0	0			
Branch A	80	0	0			
Branch B	80	0	0			
Branch C	70	0	0			
Stock at Cost :—						
H.O. Warehouse, at cost	35,000	0	0			
H.O. Selling Department, at selling price	7,500	0	0			
Branch A	7,500	0	0			
Branch B	6,000	0	0			
Branch C	9,000	0	0			
Branch Adjustment Accounts :—						
H.O. Selling Department				2,500	0	0
Branch A				2,500	0	0
Branch B				2,000	0	0
Branch C				3,000	0	0
Investments	10,000	0	0			
Cash at Bank	8,600	0	0			
Petty Cash in Hand :—						
Head Office	420	0	0			
Branch A	200	0	0			
Branch B	150	0	0			
Branch C	100	0	0			
	£145,300	0	0	£145,300	0	0

Open the necessary ledger accounts, which would be kept in the H.O. books; post the information given above; and prepare interim Trading, and Profit and Loss Accounts, and a Balance Sheet. The average "mark-up" is 33⅓ % on Selling Price, excepting bread. This, however, is taken as being the same to allow for transfer at wholesale prices from the bakery. Ignore Depreciation, and work to the nearest £.

Dr. SHARE CAPITAL ACCOUNT. Cr.

		£	s.	d.	19..			£	s.	d.
					Jan. 1	By Balance		100,000	0	0

SUNDRY TRADE CREDITORS CONTROL ACCOUNT.

Dr. Cr.

Date		£	s.	d.	Date		£	s.	d.
19... Jan. 28	To Cash	20,000	0	0	19... Jan. 1	By Balance..	25,000	0	0
" 28	" Discount	3,000	0	0	" 28	" Purchases	26,000	0	0

PROFIT AND LOSS APPROPRIATION ACCOUNT.

Dr. Cr.

Date		£	s.	d.	Date		£	s.	d.
					19... Jan. 1	By Balance..	8,000	0	0

COMMISSION ACCOUNT.

Dr. Cr.

Date		£	s.	d.	Date		£	s.	d.
					19... Jan. 1	By Balances :—			
						Branch A	300	0	0
						Branch B	200	0	0
						Branch C	200	0	0
						" Managing Director	1,000	0	0
						" Buyer	250	0	0
						" H.O. Manager ..	350	0	0

FREEHOLD LAND AND BUILDINGS.

Dr. Cr.

Date		£	s.	d.	Date		£	s.	d.
19.. Jan. 1	To Balance :—								
	Head Office ..	10,000	0	0					
	Branch A ..	8,000	0	0					

LEASEHOLD LAND AND BUILDINGS.

Dr. Cr.

Date		£	s.	d.	Date		£	s.	d.
19... Jan. 1	To Balance :—								
	Branch B ..	5,000	0	0					
	Branch C ..	6,000	0	0					

GOODWILL (H.O.).

Dr. Cr.

Date		£	s.	d.	Date		£	s.	d.
19... Jan. 1	To Balance	15,000	0	0					

MOTOR VANS, ETC. (H.O.).

Dr. Cr.

Date		£	s.	d.	Date		£	s.	d.
19... Jan. 1	To Balance	1,500	0	0					

TRADE FITTINGS, UTENSILS, ETC.

Dr.		H.O.	A.	B.	C.			H.O.	A.	B.	C. Cr.
		£	£	£	£			£	£	£	£
19... Jan. 1	To Balance	400	300	300	200						

HORSES, CARTS, HARNESS, ETC. (H.O.).

Dr.		£	s.	d.			£	s.	d. Cr.
19... Jan. 1	To Balance	400	0	0					

SUNDRY TRADE DEBTORS.

Dr.		H.O.	A.	B.	C.			H.O.	A.	B.	C. Cr.
		£	£	£	£			£	£	£	£
19... Jan. 1	To Balance	4,500	2,600	2,700	3,600	19... Jan. 28	By Cash	6,000	4,000	3,500	5,000
„ 8	„ Sales	8,000	5,000	4,000	5,500	„ 28	„ Discount	60	45	35	46

RENT, RATES, TAXES, INSURANCE, ETC.

Dr.		H.O.	A.	B.	C.			H.O.	A.	B.	C Cr.
		£	£	£	£			£	£	£	£
19... Jan. 1	To Balance	100	80	80	70						

INVESTMENTS.

Dr.		£	s.	d			£	s	d. Cr.
19... Jan. 1	To Balance	10,000	0	0					

CASH BOOK.

Dr.		£	s.	d.		Cr.	£	s.	d.
19... Jan. 1	To Balance	8,600	0	0	19... Jan. 28	By Petty Cash	810	0	0
,, 28	,, Branches	29,500	0	0	,, 28	,, Buyer	60	0	0
					,, 28	,, H.O. Manager	40	0	0
					,, 28	,, Motor Expenses	200	0	0
					,, 28	,, Stable Expenses	140	0	0
					,, 28	,, General Expenses	4,000	0	0
					,, 28	,, Creditors	20,000	0	0

PETTY CASH.

Dr.		H.O.	A.	B.	C.		Cr.	W'hse.	H.O.	A.	B.	C.
		£	£	£	£			£	£	£	£	£
19... Jan. 1	To Balance	420	200	150	100	19... Jan. 28	By Wages and Expenses	240	160	180	140	90
,, 28	,, Cash	400	180	140	90							

BRANCH CASH ACCOUNTS.

Dr.		H.O.	A.	B.	C.		Cr.	H.O.	A.	B.	C.
		£	£	£	£			£	£	£	£
19... Jan. 28	To Debtors	6,000	4,000	3,500	5,000	19... Jan. 28	By Bank	9,200	6,300	6,000	8,000
,, 28	,, Cash Sales	3,500	2,500	2,800	3,200						

SALES ACCOUNTS

Dr.		H.O.	A.	B.	C.		Cr.	H.O.	A.	B.	C.
		£	£	£	£			£	£	£	£
						19... Jan. 28	By Cash	3,500	2,500	2,800	3,200
						,, 28	,, Credit	8,000	5,000	4,000	5,500

BRANCH TRANSFER DAY BOOK.

Dr. | Cr.

19...		H.O.	A.	B.	C.	19..		W'hse.	H.O.	A.	B.	C.
		£	£	£	£			£	£	£	£	£
Jan. 28	To Transfers	11,000	9,000	8,000	8,000	Jan 28	By Transfers	36,000				
,, 28	,, Transfers	300		200	100	,, 28	,, Transfers			600		
,, 28	,, Transfers	100				,, 28	,, Transfers .. .				100	
,, 28	,, Transfers		150			,, 28	,, Transfers .. .					150

BRANCH TRANSFER ACCOUNTS.

Dr. | Cr.

19...		W'hse.	H.O.	A.	B.	C.	19. .		W'hse.	H.O.	A.	B.	C.
		£	£	£	£	£			£	£	£	£	£
Jan. 28	To Sundries		11,400	9,150	8,200	8,100	Jan. 28	By Sundries .. .	36,000		600	100	150
,, 28	,, Branch Goods Account ..	36,000					,, 28	,, Branch Goods Account ..		11,400	8,550	8,100	7,950

BRANCH ADJUSTMENT ACCOUNTS.

Dr. | Cr.

19...		W'hse.	H.O.	A.	B.	C.	19 ..		W'hse.	H.O.	A.	B.	C.
		£	£	£	£	£			£	£	£	£	£
Jan. 28	To Transfers	12,000					Jan. 1	By Stocks		2,500	2,500	2,000	3,000
							,, 28	,, Transfers		3,800	2,850	2,700	2,650

BRANCH GOODS ACCOUNTS.

Dr. | Cr.

19...		H.O.	A.	B.	C.	19...		W'hse.	H.O.	A.	B.	C.
		£	£	£	£			£	£	£	£	£
Jan. 1	To Balance	7,500	7,500	6,000	9,000	Jan. 28	By Transfers	36,000				
, 28	,, Transfers	11,400	8,550	8,100	7,950							

STOCK ACCOUNT.

Dr. | Cr.

19...		£	s.	d.			£	s.	d.
Jan. 1	To Balance, at cost..	35,000	0	0					

PURCHASES.

Dr.		£	s.	d.			£	s.	d.
19... Jan. 28	To Sundry Creditors	26,000	0	0					Cr.

SALARIES AND WAGES ACCOUNT.

Dr.		W'hse. £	H.O. £	A. £	B. £	C. £			W'hse. £	H.O. £	A. £	B. £	C. £ Cr.
19... Jan. 28	To Petty Cash ..	210	140	150	120	80							
" 28	" Cash	60	40										

SUNDRY EXPENSES.

Dr.		W'hse. £	H.O. £	A. £	B. £	C. £			W'hse. £	H.O. £	A. £	B. £	C. £ Cr.
19... Jan. 28	To Petty Cash ..	30	20	30	20	10							
" 28	" General Expenses		1,150	750	680	870							

GENERAL EXPENSES.

Dr.		£	s.	d.			£	s.	d. Cr.
19... Jan. 28	To Cash :—				19... Jan. 28	By Branches, 10 % on Sales	3,450	0	0
	Motor	200	0	0					
	Stable	140	0	0					
	General	4,000	0	0					

DISCOUNTS.

Dr.		W'hse. £	H.O. £	A. £	B. £	C. £			W'hse. £	H.O. £	A. £	B. £	C. £ Cr.
19... Jan. 28	To Sundries		60	45	35	46	19... Jan. 28	By Sundries	3,000				

NOTE.—In practice, separate accounts would be opened for each type of expense.

Uprichards, Ltd.

INTERIM TRADING AND PROFIT AND LOSS ACCOUNTS FOR THE FOUR WEEKS ENDED JANUARY 28, 19...

Dr.

	W'hse.	H.O.	A.	B.	C.
	£	£	£	£	£
To Stock	35,000	5,000	5,000	4,000	6,000
,, Purchases	26,000				
,, Transfers		7,600	5,700	5,400	5,300
,, Gross Profit		3,833	2,500	2,267	2,900
	£61,000	£16,433	£13,200	£11,667	£14,200
To Salaries and Wages ..		180	150	120	80
,, Sundry Expenses * ..		1,203	807	727	903
,, Discounts		60	45	35	46
,, Net Profit carried down		2,390	1,498	1,385	1,871
		£3,833	£2,500	£2,267	£2,900

Cr.

	W'hse.	H.O.	A.	B.	C.
	£	£	£	£	£
By Sales		11,500	7,500	6,800	8,700
,, Transfers	24,000				
,, Stocks	37,000	4,933	5,700	4,867	5,500
	£61,000	£16,433	£13,200	£11,667	£14,200
By Gross Profit		3,833	2,500	2,267	2,900
		£3,833	£2,500	£2,267	£2,900

	£
By Balance brought forward	8,000
,, Net Profit brought down	7,144
,, Over-allocation Expenses	10
	£15,154

BALANCE SHEET, JANUARY 28TH.

	£ s. d.	£	s.	d.
Share Capital (details)		100,000	0	0
Creditors:—				
Trade	28,000 0 0			
Commissions	2,300 0 0			
General Expenses	1,800 0 0			
		32,100	0	0
Profit and Loss Account:—				
Balance brought forward	8,000 0 0			
Net Profit † for period	7,154 0 0			
		15,154	0	0
		£147,254	0	0

	£ s. d.	£	s.	d.
Goodwill		15,000	0	0
Freehold Land and Buildings		18,000	0	0
Leasehold Land and Buildings		11,000	0	0
Motor Vans, etc.		1,500	0	0
Horses, Carts, Harness, etc. ..		400	0	0
Trade Fittings, etc.		1,200	0	0
Stock		58,000	0	0
Sundry Debtors..		17,214	0	0
Unexpired Insurance, etc. (say) ..		220	0	0
Investments		10,000	0	0
Bank Balance		12,350	0	0
Cash :—				
Petty Cash	£870 0 0			
Unbanked	1,000 0 0			
		1,870	0	0
		£147,254	0	0

* Includes Insurance, etc. † Subject to Directors' Fees and other expenses chargeable to General Profit and Loss Account.

NOTE —The above Balance Sheet should also show the bases of valuation of assets, etc., but such details have not been given in the question.

The value of the Stock is arrived at as follows :—

	H.O.	A.	B.	C.
	£	£	£	£
Branch Goods Account balances ..	18,900	16,050	14,100	16,950
Branch Sales Account balances ..	11,500	7,500	6,800	8,700
Stock at Selling Prices	7,400	8,550	7,300	8,250
Deduct $33\frac{1}{3}$ %	2,467	2,850	2,433	2,750
Stock at Cost Price	£4,933	£5,700	£4,867	£5,500

When preparing the final accounts, the *actual* Stock figure, as found by valuation, will be taken, any adjustment for differences being put through the Adjustment Accounts.

The over-allocation of General Expenses arises as follows :—

	£
General Expenses	4,340
Warehouse Salaries, etc.	270
Warehouse Expenses	30
Outstanding General Expenses	1,800
	6,440
Deduct Discounts received	3,000
Actual Expenses	3,440
Allocated	3,450
Over-allocation .. .. =	£10

As only Interim Accounts are being prepared, no actual transfers, other than those shown, should be made.

EXAMINATION QUESTIONS.

1. Describe a system of departmental accounts, and give its object. (*Chartered Accountants.*)

2. What are departmental accounts ? What advantages are to be derived from such accounts ? Give *pro-forma* Trading and Profit and Loss Accounts of a business divided into three departments, and state how you have allocated the indirect expenses of the business as between the various departments. (*Chartered Institute Secretaries.*)

3. If a firm having three departments desires to ascertain the separate profits of each, in what way would you suggest that the purchases and sales should be recorded ? If you recommend special forms of books, give specimen rulings for any particular business. (*Chartered Accountants.*)

4. The proprietors of a large retail store which is divided into departments ask you to design a system of accounts which, whilst showing the result of the working of each department, also provides a ready co-ordination in the work of the various departments, e.g. where goods have to be supplied to a customer upon the same order but from several departments, or where there is a necessary interchange of goods between departments. Write a report of not more than 200 words with your recommendations, giving samples of any rulings which you may think necessary. (*Incorporated Accountants.*)

5. X and Y, merchants, carry on their business through five departments, numbered 1 to 5. During their first trading period the results are :—

	Departments. 1	2	3	4	5
	£	£	£	£	£
Purchases	25,000	15,000	5,000	13,000	17,000
Sales	24,000	10,500	4,750	11,500	15,000
Stock on hand ..	6,000	7,000	1,000	3,000	6,000

The expenses which are to be charged to each department in proportion to the purchases for that department are as follows :—

	£
Salaries and Commissions	2,750
Rent and Rates	750
General Expenses	600
Insurances	250

Show the final result and the percentages on sales in each department, and also the combined results with percentage on total sales. (*Incorporated Accountants.*)

6. From the following Trial Balance prepare in departmental form the Trading and Profit and Loss Account of the Splendax Plate and Cutlery Company. The business is divided into two departments, viz. Plate and Cutlery. Also prepare a Balance Sheet at June 30th.

TRIAL BALANCE, JUNE 30TH.

	Dr. £	s.	d.	Cr. £	s.	d.
Cash	1,112	4	6			
Goodwill	3,000	0	0			
Share Capital paid up, 3,000 £10 Shares, £5 paid				15,000	0	0
Sundry Debtors	8,111	19	4			
Sundry Creditors				3,421	12	2
Stock, July 1st previous year—						
Plate Department	5,111	11	4			
Cutlery Department	3,002	8	9			
Purchases—						
Plate Department	4,112	19	5			
Cutlery Department	5,111	4	3			
Returns Inwards—						
Plate Department	111	2	2			
Cutlery Department	36	1	3			
Sales—						
Plate Department				10,335	2	8
Cutlery Department				5,148	1	6
Salaries	1,516	14	9			
Rent, Rates, and Taxes	411	19	6			
Gas, Water, and Electric Light	111	2	3			
Discounts	51	2	0			
Printing and Stationery	162	14				
Postage, Telegrams, and Telephone	76	4	9			
General Expenses	211	16	3			
Carriage (on Sales)	64	3	3			
Bills Receivable	724	5	1			
Advertising	865	2	6			
	£33,904	16	4	£33,904	16	4

NOTE.—Value of Stock on hand at June 30th: Plate Department, £2,119 8s. 5d.; Cutlery Department, £5,007 17s. 5d.

Expenses, except Advertising, are to be apportioned between the two departments according to their net sales. The cost of advertising is to be apportioned £660 to the Plate Department, and £205 2s. 6d. to the Cutlery Department.

7. A. Brown is a coal merchant, and also carries on a ticket agency. From the following particulars make out his Profit and Loss Account for the year in departmental form, showing the net profit on the two departments of his business: Stock of Coal on hand, January 1, £35; Coal Purchases, £864; Coal Sales, £1,343; Stock of Coal on hand, January 31st, £62; Wages of Carmen and Coalheavers, £180; Repairs to Coal Carts and Harness, £15; Depreciation written off Horses, £24; Depreciation written off Carts and Harness, £12; *Office Rent, Rates, and Taxes, £37; *Office Salaries, £102; Postages, Telegrams, and Telephone, £17; Advertising and Posters, £12; *Depreciation of Office Furniture, £3; Commissions received on sale of Railway Tickets, £17; Commissions received on sale of Steamship Passages, £148.

NOTE.—Items marked * are to be apportioned equally between the two departments. Apportion the Postages, Telegrams, and Telephone £13 to the Coal Department and £4 to the Ticket Department, and the cost of Advertising and Posters is chargeable entirely to the Coal Department.

8. Z. & Co. carry on business as chemical manufacturers and makers of patent medicines. From the following particulars make out their Trading and Profit and Loss Account, showing the net profits made respectively in their Chemical and Patent Medicine Departments during the year:—Stock, January 1st: Chemicals Department, £104; Patent Medicines, £121. Purchases of Raw Materials: Chemicals Department, £1,418; Patent Medicines, £78. Sales to the Public: Chemicals Department, £2,419; Patent Medicines, £3,074. Manufactured Chemicals supplied by Chemicals Department to Patent Medicines Department for further use in manufacture there, £814. Factory Wages and Salaries: Chemicals Department, £832; Patent Medicines, £416. Bottles, Cases, and Labels: Chemical Department, £37; Patent Medicines, £75. Factory Rent, Rates, and Taxes, £223; Government Duty Stamps on Patent Medicines, £50; Power, Light, and other Factory Charges, £122. Stock, December 31st: Chemicals Department, £248; Patent Medicines, £75. Office Salaries, £400; Office Rent, Rates, and Taxes, £188; Travellers' Commissions and Expenses, £214; Gas, Coal, and Electric Light (Office), £36; Printing and Stationery, £102; General Expenses, £6 1s.; Advertising, £652; Bad Debts, £35.

NOTES.—Apportion Factory Rent, Rates, and Taxes, and Power, Light, and other Factory Charges between the departments on a basis of the wages paid in each.

Apportion all Office and other non-productive expenses, except Advertising and Bad Debts, between the two departments on a basis of the sales effected by each, counting goods supplied by one department to the other for use in manufacture as being sales.

£50 of the Advertising expenses and £5 of the Bad Debts are chargeable against the Chemicals Department, the remainder relate to the Patent Medicine business.

9. Messrs. Babble & Co. publish two daily newspapers, the *Morning Screech* and the *Evening Howl*. From the following particulars prepare accounts showing the net trading result of each journal for the year:—Gross Sales: *Screech*, £51,000; *Howl*, £39,000. Returns, to be deducted from gross sales: *Screech*, £15,000; *Howl*, £4,000. Cost of Editorial Staff: *Screech*, £5,000; *Howl*, £4,000. Payments to Contributors and Correspondents: *Screech*, £22,000; *Howl*, £14,000. Payments to News Agencies

for News Supplied: *Screech*, £10,000; *Howl*, £6,000. Receipts for Advertisements: *Screech*, £40,000; *Howl*, £30,000. Cost of Advertisement Manager's Department (to be apportioned in proportion to the Advertisement receipts), £7,000. Cost of Paper used: *Screech*, £5,000; *Howl*, £4,000. Printing Department (*Salaries and Wages, £18,000; Repairs and Renewals, £1,000; Stores and Supplies, £1,000; Printing Office Rent, Rates, and Taxes, £2,000; General Expenses, £2,000; Lighting and Power, £500; Depreciation of Plant, £1,000; Sundry Expenses, £1,500), £27,000. Delivery Department: *Wages, Salaries, Motor Expenses, and General Expenses, £3,000.

NOTE.—Apportion Expenditure under the headings marked * in proportion to the Gross Sales.

10. From the following Trial Balance prepare the Profit and Loss Account and Balance Sheet of L. Smith, a manufacturer whose business is divided into two departments, viz. "A" and "B," for the year. These accounts are to be shown so as to reveal the result of the operations of each department separately as well as the combined result. The expenses appearing in the Profit and Loss Account are to be apportioned as between the two departments according to the net volume of sales for the year in each department.

	DR. £	s.	d.	CR. £	s.	d.
Freehold Land and Buildings	20,500	0	0			
Plant and Machinery	14,396	0	0			
Sundry Debtors	2,914	0	0			
Sundry Creditors				23,246	9	5
Manufacturing Wages—						
Department A	3,294	9	1			
Department B	5,291	4	9			
Manufacturing Charges—						
Department A	2,046	14	2			
Department B	3,096	4	8			
Stock on hand, January 1st—						
Department A	2,049	16	2			
Department B	5,629	14	3			
Salaries of Counting House Staff	2,249	10	0			
Rates, Taxes, and Insurance	635	9	9			
General Expenses and Commissions	1,524	18	5			
Capital Account, L. Smith				30,000	0	0
Cash at Bank and in hand	10,454	7	1			
Sales—						
Department A				11,324	9	5
Department B				16,986	14	1
Purchases—						
Department A	4,396	2	1			
Department B	3,294	1	9			
Returns Outwards, Department B				214	19	3
	£81,772	12	2	£81,772	12	2

NOTE.—The value of the Stock on hand as on December 31st was as follows: Department A, £3,092 17s. 6d; Department B, £4,924 10s. 9d.

11. From the following Trial Balance of Messrs. X. and Y.'s Stores prepare a Trading Account showing the gross profits made by the three departments (A, B, and C) into which it is divided. Also prepare a Profit and Loss Account and a Balance Sheet.

Messrs. X. & Y.'s Stores.

TRIAL BALANCE, DECEMBER 31ST.

	Dr. £	s.	d.	Cr. £	s.	d.
Capital Accounts—						
X.				2,400	0	0
Y.				1,200	0	0
Drawings—						
X.	350	0	0			
Y.	300	0	0			
Stock, January 1st—						
Department A	681	4	6			
Department B	121	2	2			
Department C	1,316	9	8			
Purchases (Gross)—						
Department A	2,212	4	6			
Department B	1,116	8	0			
Department C	2,949	1	1			
Sales—						
Department A				2,602	4	2
Department B				1,595	15	11
Department C				4,160	2	9
Transfers of Stock between departments—						
(From) Department A				100	0	5
(To) Department B	20	0	5			
(To) Department C	80	0	0			
Returns Inwards—						
Department A	10	0	0			
Department B	30	0	9			
Department C	110	17	1			
Wages and Salaries	411	2	2			
Advertising and Catalogues	240	4	6			
Dividends on Shares in M N Company				60	0	0
Shares in M N Company	1,000	0	0			
Sundry Debtors	559	8	9			
Printing and Stationery	12	1	9			
Sundry Creditors				349	2	5
Carriage	38	4	6			
Commission	82	9	8			
Postages, Telegrams, and Telephone	47	2	1			
Reserve for Bad and Doubtful Debts (as at January 1st)				10	0	0
Furniture and Fixtures	300	0	0			
Insurance	23	9	5			
General Expenses	84	2	9			
Cash at Bank	335	9	10			
Discounts and Allowances	46	2	1			
	£12,477	5	8	£12,477	5	8

Make the following provisions at December 31st: (1) Credit the partners with interest for the year on their Capital Accounts at 5 % per annum; no interest is to be charged on drawings. (2) Write off Bad Debts amounting to £99 8s. 9d., and thereafter increase the Reserve for Bad and Doubtful Debts to 5 % of the balance of debts outstanding. (3) Provide for a stationery account owing at December 31st, estimated to amount to £20; (4) Write 10 % off the Furniture and Fixtures. (5) Of the £23 9s. 5d. paid

for Insurance Premiums, £10 relates to the period after December 31st. (6) Stock on hand at December 31st: Department A, £612 4s. 9d.; Department B, £104 2s. 2d.; Department C, £1,112 8s. 9d. (7) A stock of Catalogues remains on hand valued at £30, the cost of which is included in the item of "Advertising and Catalogues, £240 4s. 6d."

12. The Olympian Patent Medicine Company manufacture two varieties of patent medicine, viz. "Hercules" ointment and "Jupiter" pills. From the following particulars prepare the Company's Trading and Profit and Loss Account for the year, showing the gross and net profits or losses on each class of manufacture :—Stock of Drugs on hand, January 1st: Ointment, £600 10s.; Pills, £80 2s. 2d. Stock of Bottles, Wrappers, and Labels, January 1st: Ointment, £125 15s. 6d.; Pills, £15 2s. 9d. December 31st, Purchase of Drugs: Ointment, £884 2s. 9d.; Pills, £246 8s. 2d. Bottles, Wrappers, and Labels: Ointment, £625 8s. 2d.; Pills, £122 8s. 4d. Manufacturing Expenses: Ointment, £1,146 2s. 6d.; Pills, £422 8s. 6d. Sales: Ointment, 256,020 boxes at 6d. each; Pills, 42,114 boxes at 1s. each. Stock of Drugs, Bottles, and Wrappers on hand at December 31, 19..; Ointment, £81 18s. 11d.; Pills, £81 4s. 11d. Advertising, £2,484 9s.; Postage, Stationery, and Printing, £207 0s. 9d.; Salaries, £414 1s. 6d.; Rent, Rates, and Taxes, and General Expenses, £621 2s. 3d. Apportion the four last-mentioned expenses between the two classes of goods according to the *number of boxes* of ointment or pills *sold.*

13. Show how you would combine the Balance Sheets and interchanging accounts of a concern having separate trading centres in London, Liverpool, and Manchester. (*Chartered Accountants.*)

14. Describe how you would treat the Accounts of Branches in the Head Office Books of a multiple-shop firm. (*Incorporated Accountants.*)

15. Miles, Further & Co., Ltd., own twenty retail provincial branches. All goods are supplied from the London Head Office and are charged out at selling prices.

The Head Office request you to devise a Supplies Journal which will record in convenient form: (*a*) Supplies to Branches (cost and selling prices); (*b*) Returns and allowances; and (*c*) Cost of packing and despatch.

Submit a suitable ruling for the above requirements, explain the advantages you claim for it, and make two specimen entries therein. (*Royal Society Arts.*)

16. A company owning 500 branch shops instruct you to prepare a suitable system of accounts. Simplicity is of the first importance, as the knowledge of accounts of the Branch Managers is very limited. The company deal in five main commodities and sundries.

You are instructed to prepare forms of accounts, so that weekly Profit and Loss Accounts may be prepared, continuous stocks kept, and cost accounts giving quantities for each branch. Give (*a*) Form of accounts to be kept at each shop; (*b*) Weekly accounts to be forwarded to the Head Office; (*c*) Head Office book of statistics. (*Incorporated Accountants.*)

17. Smith, Jones & Co. are the owners of a business working upon the multiple-shop system. No branch is allowed to purchase any Stock and can only make Petty Cash payments. All receipts are paid daily to the Credit of the firm at the local bank.

Upon what basis should goods be charged out to the Branches?

Explain the records which the Head Office Books would show in the case of each Branch. (*Incorporated Accountants.*)

18. A company, having its Head Office in London, owns a factory in South Africa. During the year 19.., £10,000 in cash has been remitted from London to the factory, and bills for £5,000, drawn by the manager in South Africa on the Head Office, have been accepted. At the end of the

year it is found that there has been a loss on the working of the factory of £2,000, which is transferred to the Head Office. Show the entries in the Head Office books recording these transactions. (*Chartered Accountants.*)

19. Messrs. Baxter & Sons, whose Head Office is in London, remitted £500 to their Manchester Branch on December 30th. The books of the Head Office and the Branch are balanced as on December 31st each year. The above-mentioned remittance did not reach Manchester until the morning of January 1st, following. How would you deal with the amount in question in the Trial Balances of the Head Office and Branch and when preparing the combined Balance Sheet of the whole business? (*London Chamber Commerce.*)

20. A. B. & Co., of London, possess several branch shops. A weekly sum is remitted to meet salaries and expenses. All goods are supplied from the Head Office, and no local purchases are permitted. All receipts are banked locally as and when received, and the local managers have no power to draw upon these banking accounts. The bulk of the sales are for cash, but a few credit sales are also effected, and are collected locally when due.

You are required to submit a form of weekly Branch Return suitable to furnish the Head Office with all the necessary information.

21. The Roget Cigarette Company, Ltd., proposes to open twenty retail shops in various towns for the sale of (*a*) Cigarettes, (*b*) Tobacco, and (*c*) Pipes and Sundries.

All goods are to be supplied from a central warehouse in London. No local purchases of goods are to be allowed.

You are required to draft instructions for the Head Office book-keeper: (*a*) As to the records to be kept in the Head Office books regarding goods forwarded to the branches; (*b*) As to the returns to be made to the Head Office by the branches; and (*c*) As to the best method of dealing with cash payments for expenses paid locally. (*London Chamber Commerce.*)

22. A. B. & Co.'s Stores.

TRIAL BALANCE, DECEMBER 31ST.

	Head Office.		Manchester Branch.		Liverpool Branch.		Hull Branch.	
	£	£	£	£	£	£	£	£
Stock, January 1st	850		450		425		275	
Goodwill	5,000							
Freehold Premises	6,500							
A. Capital Account		7,804						
B. Capital Account		7,804						
Sales		7,000		5,834		5,412		4,210
Purchases	5,000		4,208		4,000		3,000	
Sundry Debtors	658		631		567		458	
Sundry Creditors				300		276		162
Trade Expenses	78		70		63		32	
Salaries and Wages	600		450		250		250	
Rates and Taxes	139		108		150		73	
Reserve for Bad and Doubtful Debts		501						
Bad Debts	38		30		22		22	
Repairs	150							
Postages	30		21		14		11	
Liverpool		197						
Manchester		166						
Hull		251						
Head Office			166		197		251	
Investments	4,000							
Income from Investments		320						
Cash at Bank	1,000							
£	24,043	24,043	6,134	6,134	5,688	5,688	4,372	4,372
Stock, December 31st	884	—	550	—	450	—	300	—

From the above Trial Balances prepare Trading and Profit and Loss Accounts and Balance Sheet of the partnership. (*Incorporated Accountants.*)

23. Weston Wheeler, a retail trader, has three shops. His books show the following particulars at the close of his financial year on March 31st :—

	Bath.	Birmingham.	Bristol.
	£	£	£
Stock, April 1st, previous year ..	2,000	3,000	1,000
Wages	350	250	300
Rent	200	350	250
Sales	5,000	4,000	3,000
Stock, March 31st	2,000	4,000	1,500

His total Purchases were £10,500 and General Expenses £480. His buyer fixes the selling price of the goods by adding to the cost price of the goods the same percentage throughout the Branches. His general expenses are borne by each shop in proportion to its turnover. Show the net profits of each shop. (*Central Association Accountants.*)

24. In the Balance Sheet of a company submitted to you for audit, you find, amongst others, the following items :—

	£
Creditors in London (Head Office)..	10,000
Due to Manchester Branch	2,000
Due to Glasgow Branch	1,000
	£13,000

	£
Debtors in London (Head Office)	15,000
Due from Liverpool Branch	3,000
Due from Birmingham Branch	1,800
Due from Belfast Branch	200
	£20,000

What adjustments, if any, would you require before certifying? (*Chartered Accountants.*)

25. The X Z Company, of London, has a Branch at Newcastle-on-Tyne. Goods sold at Newcastle are supplied from London, but no charge is made in the books as between the Branch and Head Office. On December 31st, the Branch Balance Sheet, after closing the books, was as follows :—

Dr.	£	Cr.	£
Sales Ledger Balances ..	46,700	Bought Ledger Balances ..	3,290
Premises Extension Account, closed to Head Office	0	Head Office	44,720
Cash in hand	50		
Cash at Bank	1,260		
	£48,010		£48,010

In the six months to June 30th next, the following transactions took place at the Branch :—Sales, £54,180; Purchases, £4,200; Wages (paid), £5,700; Salaries, £560; Directors' Fees, £200; Fire Insurance Premium for one year, £480; Cash collected on account Sales Ledger Accounts, £42,000;

Discount allowed on account Sales Ledger Accounts, £2,500; Cash paid Bought Ledger Accounts, £3,800; Cash sent to London, £29,560; Premises Extension, further payments to Contractors, £1,500.

There is Cash in hand on June 30th, £60, and a Bank Balance, £1,450.

Set out the Head Office Account in the Newcastle books on June 30th, to show the entries after the books are closed, and also the Branch Balance Sheet at that date, assuming it to be made up on the same lines as on December 31st. (*Chartered Accountants.*)

26. The Southern Trading Company, Ltd., has a Head Office at London and a Branch at Southampton. From the following Trial Balances prepare a combined Balance Sheet of the whole undertaking.

LONDON TRIAL BALANCE, DECEMBER 31ST.

	Dr. £	s.	d.	Cr. £	s.	d.
Cash	511	12	6			
Stock on hand	2,214	9	8			
Sundry Debtors	5,616	4	2			
Sundry Creditors				314	1	9
Furniture and Fixtures	322	9	1			
Share Capital, 10,000 £1 Shares, fully paid				10,000	0	0
Profit and Loss Account—						
Balance, January 1st				111	19	6
Profit for year				711	19	8
Southampton Branch	2,473	5	6			
	£11,138	0	11	£11,138	0	11

SOUTHAMPTON TRIAL BALANCE, DECEMBER 31ST.

	Dr. £	s.	d.	Cr. £	s.	d.
Cash	411	12	6			
Sundry Debtors	3,112	9	5			
Sundry Creditors				2,442	1	9
Stock on hand	1,111	14	2			
London Office				1,674	1	8
Profit for year				519	12	8
	£4,635	16	1	£4,635	16	1

The difference between the London Office balance in the Branch books and the latter's balance in the London Office books is accounted for by the fact that London remitted £700 cash to Southampton on December 31st and forwarded to Southampton goods invoiced at £99 3s. 10d., both of which did not reach Southampton until January 1st following.

27. The Manager of a Branch Office receives a cheque each month from the proceeds of which he has to discharge: (*a*) The monthly trade accounts; (*b*) Salaries and office expenses.

With regard to receip s, he collects local accounts (with instructions to pay the same daily to the credit of Head Office at Bank).

Upon investigation it is found: (1) That all monthly accounts due to the firm are one month in arrear, and that the dates of vouchers have been altered to correspond with the false entries in the Branch Cash Book (copies of entries being forwarded to Head Office weekly). (2) That the Manager has paid

to each employee only half a month's salary, explaining as his reason that Head Office had short-remitted him, owing to an error in the additions, made by Head Office, in the monthly Schedule of accounts payable. (3) That the Manager has collected accounts in cash, paying part only of the proceeds to Head Office account at Bank.

You are requested to draft a scheme which, in your judgment, will prevent a repetition of such frauds. (*Incorporated Accountants.*)

III. FOREIGN BRANCH ACCOUNTS.

The subject of Foreign Exchange is briefly treated in Chap. XXII (*see* pp. 820–836). Here we are concerned with the keeping and preparation of accounts involving the element of foreign exchange, and the complications incident thereto.

The explanations previously given in regard to Branch Accounts where both the parent house and the branches operate in the same country apply also when the Head Office is domiciled in this country, and the branch in a foreign country, subject, however, to certain modifications arising from the different currencies employed in trading. No new book-keeping principles are involved; the difference arises from currency fluctuations.

Clearly, it is impracticable that the whole of the Branch books should be kept at the Head Office; the Branch must keep its own books. Head Office treats its branches as debtors for all remittances in cash or goods, and the Branches respond by treating H.O. as a creditor. The method already explained whereby Branch Profits are brought into the H.O. books by means of a debit to the Branch account also applies in principle.

The H.O. books must, of course, be kept at home in sterling to provide a sterling Trial Balance, and the Branch books must be kept abroad in the local currency in order to record details of the local trading. The transfers of value continually passing between H.O. and Branch are recorded in a Branch Account kept in the H.O. books, and complemented in a H.O. Account kept in local currency in the books of the Branch.

Book-keeping Methods.—There are three methods of recording transactions with foreign branches:

(1) Assume for book-keeping purposes that a stated sum in foreign currency is the exact equivalent of a stated sum in sterling, for example, that \$4.866 = £1. This method is employed when the currency is stable, and it is usual to take, as in the illustration, the mint par of exchange between the currencies, or the nearest round figure to the mint par.

(2) Allow the H.O. books and the Branch books to run independently, and, at balancing periods, when the figures are combined, convert the items in the foreign Trial Balance into sterling at equitable rates, having regard to their nature and the circumstances of their

origin. This method is employed when the currency of the foreign branch is unstable.

(3) Although the exchange rate between the home and the foreign currency fluctuates widely, assume an artificial parity as in (1), and make the periodical adjustments in the books required to correct the excess or defect in the valuations arising from the assumption.

(1) Stable Exchange.

Here the fixed conversion rate assumed for all inter-house transactions will obviate the futile labour that would be involved if every transaction between H.O. and the Branches were worked out at the actual exchange rate ruling on the various dates.

Mode of Procedure.—The Branch will keep both its own and its H.O. Account in local currency. Memorandum columns will be provided on either side of the latter account to accommodate the sterling equivalent of each item therein, converted at the rate adopted. The H.O. will keep its accounts in sterling, and make similar provision for the insertion on both sides of the Foreign Branch Account of the foreign equivalent of each item appearing therein. Thus the Branch Account in the H.O. Ledger, and the H.O. Account in the Branch Ledger, will be exact counterparts of each other, both as regards their sterling and their local currency columns, and if the Branch Trial Balance as a whole is converted into sterling at the agreed rate of exchange, it can be amalgamated with the H.O. Trial Balance in exactly the same way as would be followed if the Branch were a home and not a foreign one. The employment of a fixed rate of exchange links the books at home kept in sterling with the books abroad kept in local currency, and the harmony of the two sets of books (allowing for mere matters of arithmetic) is complete.

Moreover, any balance appearing in the Branch books can be written off these books, and transferred to the H.O. books through the reciprocal account kept between the two houses, always, of course, at the agreed rate of exchange. Thus, when the Branch has ascertained its profits, it can transfer them, in local currency, to the credit of the H.O. Account, and the H.O. can pass an entry through its own books, at the agreed rate of exchange, for the sterling equivalent of the profit, debiting the Branch, and crediting its own General Profit and Loss Account.

Profit or Loss on Exchange Account.—Since the harmony of the home and foreign books proceeds from the conversion of all inter-house transactions at the one invariable rate of exchange, it follows that any transactions effected at rates other than the rate adopted must nevertheless be put through the reciprocal account at the adopted and not at the actual rate, and that the difference between the two rates must be written off to a Profit or Loss on Exchange Account, or Difference in Exchange Account.

Thus, a London House, working on the basis of the fixed rate of £1 = Mks. 20, remits Mks. 100,000 to its Berlin Office, at the rate of £1 = Mks. 20.42, costing £4,897 3s. 2d. It must therefore debit its Berlin Office with Mks. 100,000 (at £1 = Mks. 20) = £5,000, and credit the difference of £102 16s. 10d. to Profit and Loss on Exchange Account. Similarly, if the Berlin Office remits London £2,000 at the rate of £1 = Mks. 20.45, costing Mks. 40,900, it must either debit London with Mks. 40,000 (i.e. at the fixed rate) and write off the difference of Mks. 900 to Profit and Loss on Exchange Account, or, alternatively, it must debit London with the sterling equivalent of Mks. 40,900 at the fixed rate = £2,045, and London must, when responding to the entry, debit £45 to Profit and Loss on Exchange Account as representing the difference between the sterling equivalent and £2,000.

Any credit balance on the Profit and Loss on Exchange Account is better carried forward as a reserve against future differences and fluctuations. Any debit balance should be written off at once.

(2) Fluctuating Exchange.

When a business house has a branch or branches in a country whose monetary unit fluctuates in its sterling value, the home office, in addition to being subject to the ordinary vicissitudes inseparable from the endeavour to earn a local trading profit, is always faced with uncertainty as to the extent to which the local profit, when earned, will be affected by exchange relations between the two countries.

Ordinary Book-keeping Principles Apply.—In the main, the ordinary routine of inter-house book-keeping applies, whether the Parent House and its Branch are located in the same, or in different countries; or, if the Branch is a foreign one, whether the local currency is stable or unstable. The Parent House keeps its books in sterling, and treats its Branch as a debtor for all remittances in money or kind, and the Branch keeps its accounts in the currency of its domicile, i.e. either in sterling, or a stable or fluctuating foreign currency, and treats the H.O. as a creditor for all credits or remittances received.

It has been shown above that where the exchange between two countries is stable a fixed conversion rate is used, and the Branch and H.O. books form the two halves of a single set of books, connected throughout the year by means of the reciprocal accounts. But when the local currency of the Branch is unstable, the H.O. and Branch books must, for the most part, be kept independently, and they cannot be combined with the H.O. books for the purpose of preparing the accounts of the whole undertaking until they have been subjected to revision in the light of exchange values.

Remittances Account.—It has already been mentioned that the H.O., in all cases, opens a ledger account for each individual foreign branch, to which remittances to or from the branch are either debited

or credited as the case may require. But when dealing with fluctuating currencies, it is preferable to record remittances in a subsidiary Remittances Account, in order to relieve the main Branch Account of the cumbersome detail. If this method is adopted, all remittances will, in the first place, be posted to the Remittances Account, and the total of that account will subsequently be transferred to the Branch Account proper. Both the Remittances and the Branch Accounts will be provided with currency and sterling columns, and the exact amount of currency will be placed against each item. The debit balance appearing in the Branch Account in the H.O. books, will, in these circumstances, represent the amount invested by the H.O. in the Branch business, and any profits that may be made by the Branch will represent the return on the investment.

Book-keeping by the Branch.—The foreign branch will conduct its book-keeping independently throughout, in the local currency. Like the H.O., it will open a Remittances Account, and also a H.O. Account, keeping both in sterling and in local currency. Allowing for the differences in dates, these accounts will be exact counterparts of the H.O. accounts. At the end of a trading period, the accounts must be reconciled by adjustments for items in course of transit, as already explained in connection with Branch and H.O. Accounts in general.

Conversion of Foreign Branch Account.—When the reciprocal H.O. and Branch Accounts have been reconciled as explained above, the Branch Trial Balance in local currency must be converted by the H.O. into a sterling Trial Balance, in order that it may be incorporated with the H.O. Trial Balance, and thus form a combined statement for the whole undertaking. But the Branch Trial Balance cannot be converted into sterling at a uniform fixed rate, as it could if the exchange were stable. Each item must be considered on its merits, and must be converted at such a rate of exchange as, in the circumstances, is most equitable. As a consequence of this treatment, the Branch Trial Balance, when converted, will not show equal debit and credit sterling totals. When all the items have been converted into sterling, the two sides are bound to disagree, and to effect the necessary agreement the difference must be inserted as a profit or a loss on exchange as the case may require.

Rules for Conversion.—The rules for converting the various items in the Branch Trial Balance are as follows:—

(1) *Fixed assets must be valued at the rate which ruled at the time of their purchase, or when funds were specially remitted to pay for them.*

The reason for this is that the assets are acquired for permanent use by the Branch, and not for sale, and once the rate is determined it should, in ordinary circumstances, remain unaltered.

Additions to fixed assets made during the trading period, and also

long term mortgages, or other fixed liabilities, should be converted on the same principle. Capital expenditure, spread over a period, may be converted en bloc *at the average ruling rate for the period.*

In some cases the fixed assets accounts are transferred from the Branch to the H.O. books, through the reciprocal accounts. In such cases they no longer appear in the Branch Trial Balance. Frequently this is a wise proceeding, since it permits questions of depreciation to be dealt with more conveniently. The transfer must be made on the principles mentioned above. It must be understood that any depreciation which it may be necessary to make is a separate matter, and must be treated separately. If the depreciation is on a percentage basis, and the asset accounts are kept in the Branch books, the rate of conversion for the depreciation (written off in the Branch books) must be the same as that employed for the asset itself.

(2) *Floating assets and liabilities, held or incurred for realisation, or payment in ready money, must be converted at the rate ruling on the last day of each trading period, just as though they had actually been realised or paid at that date.*

(3) *Profit and Loss balances, or the single balance of the Profit and Loss Account, where that alone is shown, should be converted at rates closely approximate to those ruling when the profits or losses arose.*

In practice, the average rate for the period is usually employed for conversion of the Profit and Loss balance, on the assumption that profits or losses have accrued equally throughout the period. The average rate is obtained by adding together the rates for, say, the first day of each month comprised in the period, and dividing the total by the number of days taken into average.

(4) *Remittances detailed in the Remittances Account and transferred, in total, to the H.O. and Branch Accounts respectively, and the balances of the H.O. and Branch Accounts respectively, must be brought in at the actual rates at which they were made.*

It has already been stated that the sterling Trial Balance resulting from these various conversions will fail to agree until it has been adjusted by debiting or crediting the difference as profit or loss on exchange as the case may require. But since the profit or loss on exchange arises mainly in connection with the circulating assets and liabilities, it is essential, if a loss has occurred, to charge it against current revenue. If a profit on exchange is shown, it is doubtless permissible to carry it to the credit of current revenue, but it is more prudent to place it to the credit of a Reserve for Exchange Fluctuations, in order to provide for possible future losses.

The following example illustrates the principles enunciated above :—

Illustration.—From the following Trial Balances prepare the Balance Sheet of the Nictheroy Agency and Trading Company, Ltd.

RIO DE JANEIRO TRIAL BALANCE, DECEMBER 31, 19..

	Dr.	Cr.
	Milreis	Milreis.
Cash in hand	1,500.000	
Cash at London and South American Bank, Ltd.	15,075.000	
Sundry Debtors	75,390.000	
Stock on hand	60,466.500	
Sundry Creditors		32,590.400
Land and Buildings	13,241.200	
Plant and Machinery	1,141.300	
Furniture and Fittings	1,011.200	
London Office Account :—		
Balance, January 1, 19.. = £6,250		100,000.000
Remittances during the year = £1,580 2s. 6d.		25,000.000
Profit and Loss Account (Balance)		10,234.800
Ms.	167,825.200	167,825.200

LONDON TRIAL BALANCE, DECEMBER 31, 19...

	Dr. £	s.	d.	Cr. £	s.	d.
Share Capital				4,000	0	0
Sundry Creditors				4,198	4	6
Sundry Debtors	200	0	0			
Cash at Bank	168	2	0			
Rio de Janeiro Office Account, January 1, 19.., Ms. 100,000	6,250	0	0			
Rio de Janeiro Office Remittances during the year, Ms. 25,000	1,580	2	6			
	£8,198	4	6	£8,198	4	6

The rate of exchange may be assumed to have been as follows: At December 31, 19.., 16d. per milreis; average rate for 19.., 15½d. per milreis. The Land, Buildings, Plant, Machinery, Fixtures, and Fittings were bought when the rate of exchange was 15d. per milreis. Any profit on exchange is to be placed to a Reserve for Exchange Fluctuations Account.

Foreign Branch Ledger at Head Office.—In some undertakings a duplicate of the General Ledger of each Branch is kept at the H.O. Whether this procedure is wise in any given case depends largely upon the distance between the H.O. and the Branch; the effectiveness of the control exercised by H.O.; the Branch book-keeping facilities, and other similar considerations. When a duplicate of the Branch Ledger is kept at the H.O., it is chiefly in total form, and involves, of course, the despatch by the Branch of summarised duplicates of its Cash Book, and its Purchases, Sales, and other journals. The keeping of a duplicate Branch Ledger by the H.O. affords a ready means of controlling the Branch, but it must be kept complete and up to date,

RIO DE JANEIRO TRIAL BALANCE AT DECEMBER 31, 19.., CONVERTED INTO STERLING.

Rate at which Converted.		Dr. Ms.	Dr. Rs.	Cr. Ms.	Cr. Rs.	Dr. £	s.	d.	Cr. £	s.	d.
16d.	Cash in hand	1,500	000			100	0	0			
16d.	Cash at London and Brazilian Bank	15,075	000			1,005	0	0			
16d.	Sundry Debtors	75,390	000			5,026	0	0			
16d.	Stock in hand	60,466	500			4,031	2	0			
16d.	Sundry Creditors			32,590	400				2,172	13	11
15d.	Land and Buildings	13,241	200			827	11	6			
15d.	Plant and Machinery	1,141	300			71	6	7			
15d.	Furniture and Fittings	1,011	200			63	4	0			
Actual	London Office Account			125,000	000				7,830	2	6
15½d.	Profit and Loss Account			10,234	800				660	19	11
	Ms.	167,825	200	167,825	200	£11,124	4	1	£10,663	16	4
	Profit on Exchange								460	7	9
						£11,124	4	1	£11,124	4	1

BALANCE SHEET AT DECEMBER 31, 19...

		£	s.	d.			£	s.	d
Share Capital		4,000	0	0	Cash in hand and at Bank :—				
Sundry Creditors :—					London	£168 2 0			
London	£4,198 4 6				Rio	1,105 0 0			
Rio	2,172 13 11						1,273	2	0
		6,370	18	5	Sundry Debtors :—				
Profit and Loss Account		660	19	11	London	200 0 0			
Reserve against Exchange Fluctuations ..		460	7	9	Rio	5,026 0 0			
							5,226	0	0
					Stock on hand, Rio		4,031	2	0
					Land and Buildings, Rio		827	11	6
					Plant and Machinery, Rio		71	6	7
					Furniture and Fittings, Rio		63	4	0
		£11,492	6	1			£11,492	6	1

and wholly in currency, as it would be by the Branch itself. It ranks only as a memorandum ledger, and forms no part of the H.O. accounting system. Such a ledger can, of course, be kept for any Branch, no matter what the local exchange conditions may be.

(3) FLUCTUATING EXCHANGE ASSUMED TO BE STABLE.

In some cases it is convenient, even though the exchange is unstable, to assume a fixed rate, and to conduct the book-keeping on that assumption, in the way already described as applicable to a stable exchange. This method does not always give such exact results as would be obtained by treating the foreign currency for what it is, viz. unstable, but provided periodical revaluations are made, should the actual exchange rate greatly differ from the rate assumed, it furnishes in many cases a fair working result.

By this method all transfers of funds or credits between H.O. and the Branches are passed through the Remittances Account in the H.O. books at the fixed rate adopted, any difference between the adopted and the actual cost or proceeds of any particular item being debited or credited as the case may require, to Profit or Loss on Exchange Account. The balance of the latter account needs specially conservative treatment.

Treatment of Balance of Profit and Loss on Exchange Account.—Reference should be made as far as possible to the particular transactions between the H.O. and Branch which gave rise to the nominal profit or loss on exchange in order that it may be apportioned equitably over the transactions. For example, nominal profit on exchange arising from remittances abroad to pay for the goods traded in, or to meet ordinary working expenses, should be added to the gross or net trading profit remitted from the Branch at the end of the trading period ; or, alternatively, applied to the reduction of the debits which appear in the Trading or Profit and Loss Account. Similarly, if the profit arises from remittances to defray capital expenditure, it should go to reduce such expenditure, and must not be used in relief of revenue charges. Nominal losses on exchange require like, but converse, treatment. Concurrently, the general course of the exchange must be watched, and the fixed rate adopted for book-keeping purposes must be revised in case of need.

Branch Ledger at Head Office.—When, in dealing with an unstable exchange, the adoption of a fixed rate is convenient, it is often possible, by keeping at the H.O. a local Currency Ledger for Branch transactions, to relieve the local manager from the necessity of sending to the H.O. anything more elaborate than monthly cash and store returns, and similar simple statements. This is frequently an advantage, e.g. in the case of some mining and plantation companies, where there is no expert book-keeping staff at the local office. The Branch Ledger in local currency kept at the H.O. replaces the Ledger

The Kintrang Gold Concessions, Limited.

MANAGER'S LOCAL CASH ACCOUNT FOR THE MONTH OF DECEMBER, 19...

RECEIPTS.									PAYMENTS.								
Date.	From whom Received.	From what Account Received.	Currency.		Folio.				Date.	To whom Paid.	For what Account Paid.	Currency.		Folio.			
			$	c		£	s.	d.				$	c		£	s.	d.
19... Dec. 1	Balance from last month		5,000	00					19... Dec. 5	C. Brown	Chemist's Salary for November	250	00				
,, 5	Bank of Singapore	Sales of Gold ..	5,125	00					,, 15	Cash, to Manager..	Wages for fortnight ended 14th per wages sheets enclosed	2,010	00				
,, 11	Bank of Singapore	Sales of Gold ..	374	00					,, 17	Kay Song & Co. ..	Stores purchased November 15th.. ..	650	00				
,, 26	Bank of Singapore	Sales of Gold ..	1,075	00					,, 18	Wee Kee & Co. ..	Stores purchased ..	15	00				
,, 31	Bank of Singapore	Remittance from London Office ..	5,000	00					,, 20	Manager	Petty Cash	50	00				
									,, 26	Government of Straits Settlements	Rents and dues on properties for year 19..	3,575	00				
									,, 30	Rawlings & Co. ..	Legal expenses.. ..	30	00				
									,, 31	Balance carried to next month (as certified by the Bank of Singapore)		9,994	00				
			$ 16,574	00								$ 16,574	00				

Certified as correct, C D, *Accountant.*
E F, *Manager.*

NOTE.—Sterling columns are provided in the above for use in concerns which convert each item into sterling. The conversions may, in such case, be effected either at the local office or at the Head Office in London. Where, as is very often preferable, a local ledger is kept in London in currency only, the above account forms a loose leaf cash account from which that ledger can be posted : it can also be used as a loose leaf *sterling* local cash account for ledger posting purposes if all items are converted into sterling in the columns provided.

SUMMARY OF STORES FOR THE MONTH OF DECEMBER, 19...

Stores Received.	Currency. $	c.	Sterling. £	s	d.	Stores Issued.	Currency. $	c.	Sterling. £	s.	d.
To Balance of Stores on hand at December 1, 19..	1,000	00	100	0	0	By Stores returned to Settlers	15	00	1	10	0
,, Stores received from London *ex* s.s. *India* ..	2,050	00	205	0	0	,, Stores used during month—					
,, *Stores purchases locally* ..	2,110	00	211	0	0	(*a*) In obtaining output from mine (chargeable to Revenue Account) ..	*2,990*	*00*	*299*	*0*	*0*
						(*b*) In mine development (chargeable as Capital Expenditure) ..	1,153	00	115	6	0
						,, Balance of Stores on hand at close of month ..	1,002	00	100	4	0
	$5,160	00	£516	0	0		$5,160	00	£516	0	0

Certified as correct,
A B, *Storekeeper*.
C D, *Accountant*.
E F, *Manager*.

NOTE.—In the above illustration the dollar (worth 2s.) is used for the local currency. Where a local ledger is kept in London in local currency only, the columns for sterling are not necessary.

STORES ACCOUNT.

DR. CR.

19...		Rate per $.	£	s.	d.	$	c	19...		Rate per $	£	s	d.	$	c.
Jan. 1	To Stores received from London per s.s. *Ichanga* ..	10d.	100	0	0	2,400	00	Jan. 31	By Stores used for Capital Expenditure	10d.	50	0	0	1,200	00
,, 13	,, Stores purchased locally ..	11d.	2	5	10	500	00	,, 31	,, Stores issued for Revenue Expenditure ..	10d.	10	0	0	240	00
Feb. 14	,, Stores received from London per s.s. *Oamaru* ..	10d.	200	0	0	4,800	00	Feb. 28	,, Stores used for Capital Expenditure	10d.	60	0	0	1,440	00
Mar. 6	,, Stores received from London per s.s. *Changanga* ..	9d.	187	10	0	5,000	00	Mar. 31	,, Stores used for Capital Expenditure	1s.	200	0	0	4,000	00
								,, 31	,, Balance of Stores on hand ..	1s.	169	15	10	3,395	83
								,, 31	,, Difference on currency columns transferred to Head Office Account					2,424	17
			£489	15	10	$12,700	00				£489	15	10	$12,700	00
19... April 1	To Balance brought down ..	1s.	£169	15	10	$3,395	83								

which the local office would otherwise have to keep. The method of amalgamating the H.O. Ledgers at balancing times follows the lines already laid down, the only difference being the domicile of the books.

In the case of mine accounts, the statements sent must show clearly the apportionments, as between current revenue and capital expenditure, of the cash and stores disbursed. In the case of stores, the return should take the form of a monthly debit and credit Summary showing the stores received and issued, and this must be duly balanced, and supported by detailed lists of the stores issued.

Plantation returns should give full details of the cash payments made and stores issued, and should show which of them relate to the crop account for the period, and which to future crops, or to capital expenditure.

The forms on pp. 617–19 illustrate the cash and stores accounts of a mine, the book-keeping in connection with which is done in London, on the basis of an assumed fixed rate of exchange. Plantation statements are sometimes drawn up on similar lines.

STORES ISSUED DURING THE MONTH OF DECEMBER, 19..

	Details.	Chargeable as Capital Expenditure.					Chargeable as Revenue Expenditure.				
		Currency.		Sterling.			Currency.		Sterling.		
19...		$	c.	£	s.	d.	$	c.	£	s.	d.
Dec. 1	Ropes and pitwood, Shift 1..	15	20				1,045	90			
,, 5	Fuses, ropes, pitwood, and explosives, Shift 1	80	00				234	90			
,, 9	Fuses, ropes, pitwood, and explosives, Shift 2	342	00				121	10			
,, 11	Small tools and timber, per list, Shifts 1 and 2; ropes, sand, and pitwood, Shift 2	422	80				716	80			
,, 15	Small sundries, Shifts 1 and 2	19	20				14	20			
,, 17	Small sundries for engine-house repairs	5	60				100	00			
,, 25	Small sundries for engine-house repairs	2	30				191	00			
,, 29	Oil and lubricants, engine-room	4	90				45	60			
,, 31	Fodder for ponies. Stable and engine-room supplies	261	00				520	50			
	Totals, as given in summary for month	$1,153	00	£115	6	0	$2,900	00	£299	0	0

Certified as correct.

A B, *Storekeeper*.
C D, *Accountant*.
E F, *Manager*.

(4) Transactions in Foreign Currency.

It is the British custom to invoice goods in sterling, in order that the risk of profit or loss on exchange may fall upon the foreign customer. Competition, however, renders it more and more necessary to price and invoice goods in the customer's currency, and this necessity will

probably grow more acute in the future, as competition in international trade increases. It is usual, in any case, to record sales in both currency and sterling, keeping special Foreign Sales Day Books, and Foreign Sales Ledgers, with double columns for this purpose. As each transaction is completed and paid for, the profit or loss on exchange is transferred to a special account. The following example will make the method clear :—

A of London invoices to B of New York the following :—

250 copies Library of Modern Thought .. \$1.25 each
250 copies Great Philosopher Series .. \$1.50 each

A used a fixed rate of \$4.86 = £1 for conversion in his books. B remitted a sight draft for the amount, which realised £141 15s.

FOREIGN SALES DAY BOOK.

	Ledger Folio.	Currency.		Sterling.		
		\$	c.	£	s.	d.
B, New York						
250 copies Library of Modern Thought at \$1.25		312	50			
250 copies Great Philosopher Series at \$1.50		375	00			
		\$687	50	£141	9	2

FOREIGN SALES LEDGER.

B. NEW YORK.

		\$	c.	£	s.	d.			\$	c.	£	s.	d.
To Sundries		687	50	141	9	2	By Cash		687	50	141	15	0
„ Exchange Account (profit)					5	10							

(5) BRANCH CAPITAL EXPENDITURE—FLUCTUATING CURRENCY.

The student will understand that no actually realised differences in exchange exist in connection with foreign capital assets. Cautious finance, however, acknowledges the necessity of taking all factors into consideration when including foreign Branch figures in the Head Office Amalgamated Balance Sheet.

When the parent undertaking is engaged in constructing fixed assets in a foreign country where the currency fluctuates violently, it is often essential to keep the capital expenditure accounts in the H.O. books, and in sterling, and to transfer all such expenditure from the Branch to the H.O. books at short periodical intervals. In this way the Branch books are relieved of capital assets which, to a considerable extent, are protected from exchange fluctuations. The only

balances then remaining on the Branch books are those representing floating assets and liabilities, all of which, with the possible exception of the Materials Stock Account, are properly subject to the course of the exchange.

This plan necessitates no very special book-keeping features. A Capital Expenditure Account should be kept in local currency in the Branch books, to which all capital expenditure should be debited. Memorandum columns can be added to the account for inserting against each item either the actual exchange rate, or the sterling figure at the correct rate, or both.

At the end of the fixed interval, e.g. a month, the total debit shown in local currency in the Capital Expenditure Account kept in the Branch books should be converted, either at the actual rates used for its component items, or at the average of those rates, and transferred from that account to the debit of H.O. Account. A detailed statement of the total debit should be sent to H.O. for incorporation in its books, by means of a compensating credit entry in the Branch Account and a debit entry in the Capital Expenditure Account.

All conversions, including the charging back of capital expenditure, should be effected at rates as closely approximate as possible to the actual rates experienced, i.e. either at the actual rate or the averaged rate for the period. As provided for above, this will involve keeping notes of the actual exchange rates experienced.

Local Stores Account in Sterling.—It is sometimes found useful to insert against each item in the Stores and Materials Account, kept in local currency in the Branch ledger, its sterling equivalent. Stores can then be issued on the basis of sterling cost, and the monthly sterling total to be debited to H.O. is thus easily determined. The sterling figures are then the governing figures of the Stores Account, although the currency figures are necessarily employed to prepare the general Trial Balance of the Branch Ledger. Each receipt or purchase of stores is debited in sterling and in currency, the conversion rate being the rate ruling at the time of purchase. Each issue of stores, whether for local revenue expenditure or for capital expenditure on behalf of the H.O., is credited at its sterling cost, the local currency figures inserted being the equivalent of that cost at the rate of exchange on the day of issue. The sterling equivalent of stores issued for local revenue purposes is of no interest apart from the Stores Account, and such items find their way to the local Profit and Loss Account *in currency only*. When balancing the Stores Account, the sterling balance in the memorandum columns should be inserted and extended to the currency columns at the rate ruling on the last day of the period covered by the account. The sterling columns will thus agree, but the currency columns will show a difference on one side or the other, which must be written off, in currency only, to the debit or credit of H.O. Account, and is thus eliminated. The H.O. will respond to the

entry in currency only, and since the currency columns of the H.O. books are of purely statistical interest, the adjustment of the difference is of no consequence.

EXAMINATION QUESTIONS

1. What do you understand by "exchange" as between countries? Explain why the rate of exchange between two countries fluctuates from day to day. (*Chartered Accountants.*)

2 Describe briefly how international trade dealings are settled. (*Royal Society Arts.*)

3. H. E. Richardson & Co., of London, desire to remit £396 8s. 6d. to Hokoashi & Co., of Kobé, Japan. Describe three different methods of effecting the remittance which are open to Richardson & Co. (*Royal Society Arts.*)

4. Briefly explain the expression "par of exchange." (*Royal Society Arts.*)

5. Explain the mutual relations of the rates of discount ruling in any two given monetary centres and the rates of exchange between such centres. (*Chartered Institute Secretaries.*)

6. In consequence of the war, the rates of exchange all over the world have been subject to violent fluctuations. Explain a system whereby the comparison of the Annual Trading Account figures may be preserved and the item "Loss in Exchange" eliminated. (*Incorporated Accountants.*)

7. What is the "mint par of exchange"? Explain why it varies from the actual rate of exchange from time to time. (*Chartered Accountants.*)

8. The undermentioned items, amongst others, appeared in *The Times* newspaper, in a column headed "Foreign Exchanges": Paris, 124–124$\frac{1}{8}$; New York, 4.87–4.87$\frac{1}{16}$. Interpret the meaning of the items quoted. (*Royal Society Arts.*)

9. How would you treat Foreign Branch Accounts in the following cases: (1) Where the rate of exchange is stable; (2) Where the rate of exchange is fluctuating? Explain on what basis you would incorporate the accounts of the Foreign Branch in the Head Office books, taking France as an example of a stable rate and Brazil as an example of a fluctuating one. (*Chartered Accountants.*)

10. Messrs. Pernet Ducher & Co., Ltd., London, have a branch office in a South American Republic, where the exchange fluctuations are considerable. The books of the Branch are kept in local currency only, and, at the close of each financial year, a Trial Balance, Profit and Loss Account and Balance Sheet are sent to the London office.

Briefly describe how you would amalgamate the Branch figures with those of the Head Office.

At what rates would you convert (1) the Profit and Loss Account balance; (2) the Floating Assets; (3) the Fixed Assets; and (4) Remittances from London? (*London Chamber Commerce.*)

11. A London company, owning a mine in India, receives monthly cash statements, in Indian currency, from its local manager.

How would you pass these returns into the company's books and effect the necessary conversion into sterling?

Illustrate your answer by means of rulings of the book or books you would suggest, and enter therein six imaginary transactions. (*London Chamber Commerce.*)

12. A firm in London owns a business in Russia, and receives from the local manager a monthly statement of the transactions in Russian currency. How would you give effect to these transactions in the London books? Give

rulings and three imaginary entries. (The approximate value of a Russian rouble = 100 kopecks is 2s. 1½d.) (*Central Association Accountants.*)

13. A and B, carrying on business in London, had established a branch in New York on January 1, 1913, sending over Stock and Cash to the value of £1,000 as working capital. In the London books this appeared as "Capital, New York, £1,000." The equivalent in the New York books was \$4,875. Profits were made in New York as follows: 1913, \$2,762.43; 1914, \$3,419.40; 1915, \$4,350.15. As on December 31, 1915, the Branch was sold, the purchasers paying \$10,000 for the goodwill, and taking over assets and liabilities at book figures. They remitted the full amount by draft (the exchange being \$4.76½), and this had come to hand before the London accounts were closed for 1915. By arrangement, no New York profits had previously been brought into the London books. A and B, sharing profits five-eighths and three-eighths, make the necessary Journal entry in the London books to explain and close the transaction, as far as possible, as on December 31, 1915. (*Chartered Accountants.*)

14. In preparing the Balance Sheet of a Bank having foreign branches, at what rates should the currency figures of the Balance Sheet and Profit and Loss Account be converted into sterling in the case (*a*) of a Branch in France; (*b*) of a Branch in Brazil? How would you deal with any difference arising on conversion? (*Chartered Accountants.*)

15. You are auditing the accounts of a Liverpool merchant, with branch houses in New York, Valparaiso, and Lima, and owning freehold premises in each of those places, debited in the books of such branches respectively. The balance of assets over liabilities at each branch is translated at the rate of exchange ruling at the date on which the balance is taken, and treated as an asset in the Balance Sheet of the firm. Can you pass these entries? If not, state fully what adjustments would, in your opinion, be necessary (*Chartered Accountants.*)

16. At what rates of exchange would you convert the following classes of balances, in the Trial Balance of the Brazilian Branch of a British limited company, for incorporation in the London books of the company at the end of a financial year? Give a reason for your answer in each case. (*a*) Fixed Assets; (*b*) Floating Assets and Current Liabilities; (*c*) Profit and Loss balance; (*d*) Remittances. (*Chartered Accountants.*)

17. A. Brown & Co., London and Rio de Janeiro.

RIO DE JANEIRO TRIAL BALANCE, DECEMBER 31ST.

	Dr. Milreis.	Cr. Milreis.
Freehold Land and Buildings (at January 1st)	250,000	
Freehold Land and Buildings (additions during year)	11,000	
Stock of Goods on hand (December 31st)	32,032	
Sundry Debtors	160,640	
Sundry Creditors		96,656
Bills Receivable	48,496	
Investment: Milreis 50,000 State of Amazonas Internal 5 % Bonds, bought at 90	45,000	
Cash at London & Brazilian Bank	49,632	
Profit and Loss Account (balance, December 31st) ..		60,672
Head Office Account (balance, January 1st)		599,472
Remittance Account (£10,000 remitted to London) ..	160,000	
	Ms. 756,800	Ms. 756,800

From the above information prepare the Trial Balance for incorporation with that prepared from the London books.

The Freehold Land and Buildings are to be converted at the rate ruling when the assets were purchased (15¼d. per milreis), and the additions at the average rate ruling for the year (15½d.). The rate ruling at the close of the year was 15d. The Investment was bought as a permanent investment and is to be treated as having been bought at a time when the rate ruling was 16d. The equivalent of the Head Office Account balance (Ms. 599,472.000) as shown by the London books is £37,469 12s. 7d.

18. Prepare from the following figures a detailed statement, in a concise form, showing that the surplus assets abroad would be sufficient to provide for the excess liabilities (including Capital) in England :—

	England.			Mexico.	Burmah.		
	£	s.	d.	Dollars.	Rs.	a.	p.
Cash	1,075	2	10	10,400.75	1,35,990	14	6
Creditors	120,080	10	10	35,888.54	7,58,900	12	0
Debtors	13,822	10	4	16,952.12	1,97,886	12	2
Bills Receivable	17,128	10	6		3,75,000	15	10
Bills Payable	60,220	18	6		4,350	14	2
Investments	14,954	6	8	2,000.00	30,600	0	0
Shipments	70,426	16	11	5,541.02	1,05,989	10	0
Stock	440	14	6	160,072.25	6,45,763	4	8
Reserves	100,000	0	0	2,000.00	1,50,000	0	0
Share Capital	150,000	0	0				
Profit	3,857	13	10				
Payments in Advance	444	4	4	7,420.90	85,275	2	0
Properties	220,000	0	0	12,000.00	1,65,000	0	0
Advances to Natives					3,45,000	0	0

The dollar to be converted at 2s. and the rupee at 1s. 4d (16 annas = 1 rupee, 12 pies = 1 anna). (*Chartered Accountants.*)

19. The Chemical Supply Company, Ltd., London, has branches at Calcutta and Bombay. The nominal Capital of the Company is £20,000, divided into 10,000 Ordinary and 10,000 Preference Shares of £1 each.

The accounts of the Indian branches are audited by a firm of chartered accountants, who supplied the following Balance Sheet as on June 30, 19.. :—

LIABILITIES.	Calcutta.	Bombay.	ASSETS.	Calcutta.	Bombay.
	Rupees.	Rupees.		Rupees.	Rupees.
London Office ..	136,305	67,110	Stock	104,580	63,255
Creditors	700	1,780	Debtors	40,830	4,300
Bad Debts Reserve	2,550	1,400	Fittings and Furniture	6,350	950
Bombay Branch ..	1,950	—	Calcutta Branch..	—	1,950
Profit for the year	12,280	8,275	Formation Expenses	—	1,250
			Cash in hand and at Bank	2,025	6,860
Rs	153,785	78,565	Rs.	153,785	78,565

For the purposes of conversion, the rupee may be taken at 1s. 4d.

The Head Office Trial Balance on June 30, 19.., was as follows :—

Credit Balances : Sales, £7,775 ; Bad Debts, £97 ; Preference Share Capital, £5,000 ; Sundry Creditors, £6,635 ; Commission Earned, £30 ; Ordinary Share Capital, £5,500 ; Bills Payable, £1,980.

Debit Balances : Purchases, £6,150 ; Freight Duty and Export Charges, £155 ; Wages and Salaries, £255 ; Trade Expenses, £60 ; Formation Expenses, £940 ; Postages, Telegrams, and Telephone, £56 ; Calcutta Branch, £9,387 ; Directors' Fees, £250 ; Cash in hand and at Bank, £650 ; Profit and Loss Account balance, June 30th, £2,850 ; Stock, June 30th, £40 ; Rent and Rates, £30 ; Stationery and Advertising, £75 ; Bank Interest and Charges, £22 ; Furniture and Fittings, £31 ; Bills Receivable, £45 ; Bombay Branch, £4,474 ; Commission Paid, £127 ; Sundry Debtors, £1,020.

On June 30th following the London Stock was £150 and the Stock of Stationery £45.

Cash in transit from Calcutta, £300.

Reserve £170 for Commission Earned, and £120 for Bad Debts.

The Calcutta manager is entitled to a commission on the surplus profits of the Company in each year, after paying the Preference Share dividends, of £10 in respect of each 1 % earned on the Ordinary Share Capital

Prepare Trading and Profit and Loss Accounts for the year ended June 30th, and Balance Sheet as on that date. (*Chartered Accountants.*)

20. From the following Trial Balances prepare the Balance Sheet of the South American Produce Company, Ltd., as at March 31st :—

South American Books.

	Milreis.	Milreis.
Sundry Debtors	155,000	
Sundry Creditors		60,600
London Office Account (£9,812 10s. 5d.)		154,206
Cash at Bank	12,040	
Furniture (purchased April 1st, previous year)	3,216	
Stock	118,050	
Profit and Loss Account, Net Profit for the year		73,500
	Ms. 288,306	Ms. 288,306

London Books.

	£ s. d.	£ s. d.
Share Capital, 5,000 shares at £5 each (£3 paid up)		15,000 0 0
South American Account (remittances at actual rates)	9,812 10 5	
Cash at Bank	8,475 1 7	
Profit and Loss Account, balance at April 1st		3,287 12 0
	£18,287 12 0	£18,287 12 0

Rate at April 1st, 1s. 4d. per milreis. Average rate, 1s 3½d. per milreis. Rate at March 31st, following, 1s. 3d per milreis. (*Central Association Accountants.*)

21. From the following Trial Balances prepare the Balance Sheet of the San Paulo Trading Syndicate, Ltd., as at June 30th.

SANTOS TRIAL BALANCE, JUNE 30TH.

	DR. Milreis.	CR. Milreis.
Cash at Bank of Brazil, Santos	7,500	
Stock of Goods on hand	75,500	
Sundry Debtors	68,500	
Bills Payable		17,000
Furniture and Fittings, balance at December 31st last	2,000	
Furniture and Fittings, additions from January 1st to June 30th	1,500	
Profit and Loss Account balance, being Net Profit for the half-year ended June 30th		14,000
London Office Account (£7,767 3s. 9d.)		124,000
	Ms. 155,000	Ms. 155,000

LONDON TRIAL BALANCE, JUNE 30TH.

	DR. £	s.	d.	CR. £	s.	d.
Share Capital issued: 10,000 £1 Shares, 15s. per share paid				7,500	0	0
Cash at Bank	85	0	11			
Santos Office Account, Ms. 124,000 at actual remittance rates	7,767	3	9			
Profit and Loss Account, balance brought forward from last year				352	4	8
	£7,852	4	8	£7,852	4	8

Current rate of exchange, December 31st, 15d per milreis. Current rate of exchange, June 30th, 16½d. per milreis. Average rate for first half of year, 16d. per milreis.

Furniture and Fixtures on hand at December 31st were bought at 15d. per milreis; the additions during the first half of year were bought at 16d. per milreis.

22. From the subjoined Trial Balances, extracted from books kept respectively at the London and Paris offices of Reville & Co., Ltd., prepare the combined Balance Sheet of the undertaking as on December 31st. A fixed rate of exchange of Fcs. 25.20 to the £ is employed in the business.

Reville & Co., Limited.

LONDON (HEAD OFFICE) TRIAL BALANCE, DECEMBER 31ST.

	DR. £	s.	d.	CR. £	s.	d.
Share Capital				10,000	0	0
Stock of Goods on hand (December 31st)	3,295	12	6			
Sundry Debtors	1,926	14	3			
Sundry Creditors				4,991	6	2
Freehold Premises	8,050	12	6			
Furniture, Fittings, and Fixtures	132	9	5			
Bills Receivable	450	0	0			
Cash at Bank	456	15	11			
Cash in hand	10	9	6			
Paris Branch Account (Fcs. 42,800 at 25.20)	1,698	8	3			
Profit and Loss Account (London), Net Profit for year				1,029	16	2
	£16,021	2	4	£16,021	2	4

PARIS BRANCH TRIAL BALANCE, DECEMBER 31ST.

	Dr. Francs.	Cr. Francs.
Sundry Debtors	40,800.05	
Sundry Creditors		28,000.00
Stock of Goods on hand (December 31st) ..	12,500.00	
Furniture, Fittings, and Fixtures	2,000.00	
Bills Receivable	4,500.00	
Cash at Bank	13,097.50	
Insurance paid in advance (proportion unexpired)	98.00	
Cash in hand	1,926.00	
London Office Account (remittances received) ..		42,800.00
Profit and Loss Account balance, being Net Profit for the year		4,121.55
	Fcs. 74,921.55	Fcs. 74,921.55

23. W. P. & Co., Ltd., whose registered office is in London, have a Branch of their business in Paris. Both the London and Paris houses prepare their own Balance Sheets, and the following figures represent the Balance Sheets of the two houses on December 31st. You are requested to combine the two accounts.

A fixed rate of exchange of 25.12 is used in the business

LONDON BALANCE SHEET, DECEMBER 31, 19..

	£		£
Share Capital	25,000	Premises	10,000
Creditors	500	Debtors	8,495
Bank	5,000	Furniture	125
Paris Branch Account ..	12,500	Bills	1,430
Profit and Loss Account ..	2,495	Cash in hand	327
		Stock on hand	25,118
	£45,495		£45,495

PARIS BALANCE SHEET

	Francs.		Francs.
Creditors	325,500.00	Debtors	8,500.50
Profit and Loss Account	3,876.00	Furniture, etc.	1,500.00
		Cash in hand	125.25
		London Office Account	314,000.00
		Stock	5,250.25
	Fcs. 329,376.00		Fcs. 329,376.00

(*Incorporated Accountants.*)

24. A firm of London merchants received a Trial Balance from their Branch abroad—where the exchange is liable to considerable fluctuations—and incorporated the items in the London books at the rate of exchange ruling as on the date of the Trial Balance (December 31st). The Tria Balance contained the following items: Premises, Plant, Sundry Creditors, Sundry Debtors, Stock, Cash in hand, London Office Account, and Profit and Loss Account.

Do you approve of the above proceeding? If not, how would you deal with the Branch Trial Balance in the London Books? (*Royal Society Arts.*)

CHAPTER XV

STORE-KEEPING AND COST ACCOUNTS

I. STORE-KEEPING.

Stores Records Essential.—Before discussing cost accounts, attention must be devoted to store-keeping records, since stores records should be kept, whether a proper costing system exists or not. The word "Stores" in this connection means the raw materials or other articles used in manufacturing goods or for carrying on a business; whereas "Stock" connotes finished goods held primarily for sale. These terms are frequently confused. Raw material is, of course, a relative term, for what is a finished article in one factory may be raw material in another. Although many businesses sell raw materials as well as finished articles, such raw materials are dealt with as stores, appropriate entries being made in the accounts for issues to the merchanting department. In every business it is essential to maintain a proper check upon those numerous items passing in and out of stock included under the vague title "General Stores." In a manufacturing business such records are vital to accurate pricing and invoicing of goods sold or work done, and slackness or inefficiency in keeping stores, and the records of their receipt and issue, will vitiate the results of any costing system.

An Efficient Store-keeping System.—The diversity of raw materials employed in different businesses makes it impossible to lay down hard-and-fast store-keeping rules or to submit stereotyped rulings capable of universal adoption. The system and rulings employed must be adapted to each particular business. Any attempt to make the business fit into a standard system is foredoomed to failure. All that can be attempted here is to outline the main principles applicable to store-keeping systems.

Ample floor space is a first essential to orderly and efficient store-keeping. Lack of proper control in the stores department is a certain source of trouble. Further, the store-keeper must be trustworthy and capable; and the system must work correlatively with the financial and costing records of the business, and must furnish an efficient check upon all goods entering and leaving store. Reliable store records will eliminate waste and extravagance, permit accurate estimating and prevent loss of interest on capital locked up in obsolete

stock. In view of the reluctance of most manual workers to undertake clerical duties, the books should be as few and as simple as possible and the clerical work be reduced to a minimum. In that way, reliable results will be obtained more easily, since the store-keeper's time is usually and more properly occupied in the manual work of handling the goods in his charge. The actual stores ledgers should not be written up by the store-keeper, but by a member of the counting-house staff.

Incoming Goods.—On entering the works, all bales or bundles of goods should be checked against the copy of the order and the delivery note as regards number and weight by the gate-keeper, and entered in a Goods Inwards Book. This book should be regularly checked with the store-keeper's Reports, the Delivery Notes, and the Invoices by a member of the counting-house staff. The store-keeper should check the contents of the packages for quality and quantity, and send the delivery note, duly initialled, with his report to the counting-house, where it should be checked with the original order and the invoice. Any goods below sample or specification or otherwise defective should be held on one side pending instructions from the counting-house or works manager. If they are to be returned, an authorisation should be sent to the store-keeper and a duplicate to the gate-keeper so that the latter can pass them out.

Bin Cards.—Goods received should be entered in the Stores Purchases Book as mentioned later. The materials in stock should be recorded on separate cards attached to each bin, sack, shelf, or locker, and the store-keeper will note on these cards particulars of all goods received into or withdrawn from stock. Where symbols are used to distinguish goods, these will also be recorded. Simple forms of Bin Cards are illustrated below.

BIN OR LOCKER CARD.

No. of Bin .... Where kept ....

Nature of Goods .... Limit : Maximum ....

Symbol .... Minimum ....

Stock Received.			Given out on Requisitions.			Balance on Hand.
Date.	From whom.	Quantity or Weight.	Date.	Required for.	Quantity or Weight.	Quantity or Weight.

BIN OR LOCKER CARD.

.... DEPARTMENT.

Bin No. .... Description.......................

Stock and Added Since.						Taken Out Since.					
Size.	No.	T.	C.	Q.	L.	Size	No.	T.	C.	Q.	L.

NOTE.—This card is suitable to attach to bins or lockers prior to stock-taking. It is particularly helpful for stock-taking purposes in cases where a count can take place a few days beforehand. On the actual day of stock-taking, individual checks or tests are made here and there, and the cards are collected and dealt with in the office.

In cases where quantities of special goods are purchased for specific jobs or contracts, against which they are earmarked, it is advisable to add a note to that effect in red or to enter them in an additional column provided for that purpose, so that the balance available for general issue may be clearly seen. Alternatively, special Bin Cards (with or without special Bins) may be provided. Neglect of these precautions may involve the business in considerable inconvenience, or even in direct loss, e.g. where lack of sufficient material causes a definite stoppage of progress, or delays it sufficiently to bring into operation a penalty clause in the contract.

As a general rule, the values of goods in store should not be shown on these cards, nor should they appear in any records kept by the store-keeper. The cards are totalled periodically, and checked and agreed by an independent clerk with the balances shown in the Stores Ledger. The total of the balances appearing on the Bin Cards should agree with the relevant balances in the Stores Ledger, and so should greatly facilitate stock-taking. Any discrepancies disclosed must be enquired into at once. Such enquiries are often tedious, but to delay investigation is fatal. A note should be made at these periodical inventories of any stocks which have not been operated upon for some time or which are deteriorating in value by storage. A serious waste of working capital occurs if it is allowed to remain locked up in obsolete stocks, and steps should be taken to realise the stocks at the best price obtainable. The " maximum " stock allowed for stores should, in respect of little-used stores, be reduced to more appropriate quantities, and the " minimum " stock for such stores may also be capable of reduction.

Receipt of Goods into Store.—When the stock of any particular material is running low (i.e. nearing the fixed " minimum ") the store-keeper must send a formal requisition—a Store-keeper's Requisition

Form—to the ordering and buying department specifying the materials required. Frequently these requisitions have to be passed by the works manager before they go to the buying department. When the buying department has ordered the requisitioned goods, an advice note will be sent to the store-keeper informing him what goods he is to expect. The usual procedure is to make out all orders in triplicate books. One copy goes out as the actual order; a second goes to the store-keeper as a check upon the incoming goods, and the third remains on record in the order book for reference in case of need. In no circumstances should the store-keeper be allowed to order goods direct. Particulars of these requisitions should be recorded by the store-keeper in a Stores Requisition Book (*see* p. 634), and full particulars of the actual *quantities* of goods received should be recorded against the requisitions. To facilitate posting, the Goods Received Books should be kept in duplicate for alternate days. In some cases loose daily Goods Received Sheets are preferred for convenience in circulation.

It is not wise to hand the invoices for goods to the store-keeper lest he be tempted to avoid the trouble of an independent count and assume that the invoiced quantities are correct. The invoices should be checked in the counting-house against the goods received records in the Stores Purchases Book, and deficiencies should be reported at once to the suppliers of the goods.

In some instances the store-

STORES PURCHASES BOOK.

Requisitions.				Goods Received														
Date.	No. of Requisition.	Particulars.	Quantity.	Date of Delivery Order or Credit Slip.	Order No	From whom Received.	Particulars.	Quantity.	Weight.				Price.	Amount.			Folio.	No. of Bin Card.
									T.	C.	Q.	L.		£	s.	d.		

STORES LEDGER.
(Left-hand Page.)

Nature of Goods .... No. of Rack ....

RECEIVED INTO STOCK.

Date.	Order No.	Folio.	By whom Supplied.	No. of Invoice *or* Credit Slip.	Quantity.	Weight.				Price per Unit	Amount.			
						T.	C.	Q.	L.		£	s.	d.	

STORES LEDGER
(Right-hand Page.)

Maximum Stock .... Minimum Stock ....

ISSUED OUT OF STOCK.

Date.	Requisition No.	Folio.	To whom Issued.	Quantity.	Weight.				Price per Unit.	Amount.			Balance in Hand (Quantity or Weight).
					T.	C.	Q.	L.		£	s.	d.	

General Note re Rulings.—It will be seen that columns for "Amounts," etc., have been included in certain of the rulings recommended. These columns should not be filled in by the store-keeper, but by the counting-house staff. *It is an advantage to keep these records on the loose-leaf or card system*, the store-keeper being handed the sheets necessary for each day, and being made responsible for their return daily to the counting-house, whether used or not.

keeper will receive goods that he has not requisitioned, the buying department having directly ordered goods for particular jobs or contracts. These goods will be recorded by the store-keeper in the Stores Purchases Book and their arrival be notified to the buying department.

Where partially or completely manufactured goods are received into store from the works, they may conveniently be recorded in a special Stores Received Book ruled similarly to the Stores Purchases Book.

Issue of Goods from Store.—It must be a rigidly enforced rule that no goods shall be allowed to leave the store except against a properly completed Requisition Form, in the same way that no goods should be allowed to leave the works except against a properly authenticated Pass-Out Form. Each foreman should be supplied with a carbon copy book of requisition forms in duplicate or triplicate, one copy being retained in the book, one going to the store, and (where considered advisable) one being sent direct to the counting-house. Similar books should be issued for credit slips. These requisition forms require careful scrutiny, as the accuracy of the eventual charging up of the job or contract depends upon the care with which the particulars are recorded. The requisitions must be signed by the foreman requiring the goods, and must state the date, the quantity required, and the order number of the job or contract for which the stores are to be used. If the stores are taken by a messenger, he should sign or indorse the requisition form. Adequate control must be exercised to prevent continual ordering of small quantities with the attendant expense of increased recording and waste of time on small issues, on the one hand, and over-ordering with increased risk of carelessness and spoilage on the other hand. At the close of each day or shift, the requisition forms should be handed to the costing clerks.

At times there is bound to be a quantity of stores remaining over from a job or contract. Particulars of such surpluses should be entered by the foreman on a Credit Slip or Materials Return Note and the stores returned to the store-keeper, who must treat them as an entirely fresh receipt of stores. In some cases it may not be convenient to return these "overs" to store. Where, for example, a builder is erecting houses on a distant site, it would be futile to return the bricks, cement, sand, etc., left over from one house, and then to reissue the material from store, possibly, to another house in course of erection on a contiguous site. To meet such cases a Transfer Slip, or Materials Transfer Slip, similar to the requisition and credit slips, must be made out by the foreman transferring the stores and be signed by him, by the receiving foreman, and by the site superintendent, and sent to the counting-house, a copy being retained as before. Supervision over transfers of this kind is essential, otherwise certain jobs will gain at the expense of others, and both costs and future estimates will be vitiated. These transfers do not concern the store-keeper, but are handed to the costing clerks for transfer from one job or contract to the other.

REQUISITION FORM.

STORES REQUISITION.

No. .... Date .... 19...

Goods required for .... (job or contract number).

Counterfoil.	Particulars.	Quantity.	Weight.				Price per Unit.	Amount.			Reference Folio.
			T.	C.	Q.	L.		£	s.	d.	
Requisition No.											
Date											
No. of Order .... (Details of Materials demanded)	Demanded by										
Initials	Supplied by										

STORES ISSUED BOOK.

Date.	No. of Requisition.	To whom Issued.	Particulars.	Quantity.	Weight.				Price.	Amount.			S.L. Folio.
					T.	C.	Q.	L.		£	s.	d.	

Consumable stores or materials issued for general use (e.g. oil, waste, grease, repair stores, etc.) should be recorded as issued to the department concerned, and, if needed for machine repairs, the shop number of the machine should be entered, so that the proper manufacturing charge may eventually be formulated. Requisition forms for stores for general use are frequently printed on coloured paper.

All goods issued should be recorded in the Stores Issued Book, from which postings to the Stores Ledger are effected. It may be convenient to duplicate this book under various headings to avoid subsequent analysis; and, where the work is heavy, separate books for alternate days or weeks will help to keep the work up to date. Materials purchased for special contracts or jobs may, if desired, be recorded in a separate book.

The Stores Ledger.—This ledger records the whole movement of stores both inwards and outwards, and the balances extracted from it at any time should represent the actual quantities and values of the stores in hand. This ledger should be kept in the counting-house by a special clerk (or clerks), whose duty it will be to analyse the invoices, requisitions, credit slips, transfer slips, etc., and to post the Stores Ledger. Briefly put, the accounts in the Stores Ledger are written up as follows: All goods going into store are *debited* from the Goods Inward Book (Stores Received Book), the credit slips, and transfer slips. All goods going out of store are *credited* in accordance with the details shown on the Requisition Forms. The above debits and credits will supply *quantities* or *weights* only. The *values* will be obtained from the invoices or from the cost prices adjusted by the Costing Department, as explained later. The balances shown on the Stores Ledger should agree with and afford a check upon those on the Bin Cards and also a check upon the *financial values*. A separate ledger opening must be provided for each item of sufficient importance to warrant a separate account. Small items, when numerous, must be grouped with those of a like kind. A note of the location of the bin or locker, and the maximum and minimum amounts of stock (in quantities) which are to be carried, should appear at the head of each account. When the minimum is reached, immediate notice must be given to the ordering department.

A "total account" should be built up for the Stores Ledger, or if there are several ledgers, for each ledger. When the individual invoices are debited to the appropriate class of store, they should be summarised and credited in total to the Total Account. The requisitions (less credit slips) should be debited in total to this account, so that the double entry may be completed at each stage and the balance of stores in hand seen at any time. Care must be exercised in compiling the figures, which, when accurately kept, are of great assistance to the ordering department, and at stock-taking, and at

an internal check upon stores. The employment of the card or loose-leaf system greatly facilitates the compilation and the arrangement of store records, and is gaining in popularity.

A very important question that remains for discussion is the price or value to be placed upon stores for costing purposes. Differences of opinion exist upon this question, but the methods explained below will be found practical and in general use.

Methods of Arriving at Values for Stores Ledger Entries.—The values to be debited to each class of goods in store should, in the case of bought goods, be the invoice price less trade discount. In the case of goods partially or wholly manufactured in the works, cost price may be adopted, although, as will be discussed later, a comparative wholesale price, or other " loaded " value, is sometimes used. Pricing out issues of goods is rather more complicated. For costing records, all inward charges (e.g. carriage, freight, cartage, duty, etc.) must be taken as forming part of the cost of the goods for issue purposes, and this addition to invoice cost will operate to throw the ledgers out of balance, unless such inward charges are debited to the relative stores accounts or are subsequently adjusted. It is therefore advisable that this adjustment should be made where the stores ledgers are used in conjunction with a costing system, otherwise it is not so important, and the goods can be issued at the net invoice cost. If the prices of materials do not vary throughout the period under review, there is little difficulty in arriving at an accurate price per unit of issue, and in such cases the original cost price would be adhered to. In practice, however, it is usual for market prices to fluctuate from time to time, and it is necessary, therefore, to adjust the issue prices accordingly. In some cases monthly averages are taken as the basis for the ensuing month. Where issues are made in bulk, it is possible to use the original cost price of the oldest stock on hand, on the basis that the goods which came in first will be issued first—this tends to prevent the accumulation of obsolete stocks. Advocates of " real costs " contend that this is the only sound method. If an issue comprises goods bought at different times and prices, two issue prices, or an " equated " price, has to be arrived at. This method is more conservative—when an estimate has been based upon the cost of material in stock at the time when the tender was prepared—since, even if the price of raw materials rises before the contract is executed, the business has covered the necessary supply at a price which will ensure a profit. This eliminates the gambling element when buying materials. The proper pricing of goods is, of course, the work of the Costing Department, where a *Price Record Book* should be kept containing particulars of past and current prices.

A second method is to charge out the goods at the current market price at the time of issue. It will be clear that if stores are priced out at any other figure than actual cost, either a profit or a loss will be

shown on the stores accounts, and this fact will complicate the reconciliation of the *values* in the stores accounts, and will increase the difficulty of agreement between the costing and the financial records, if this achievement be desired. In many cases, however, this will not be regarded as a very serious objection provided *quantities* are agreed. This second method certainly tends to make competition more rational, as costs will be based on lines comparable with those of businesses which buy as they go.

When pricing out the issue of goods in comparatively small quantities, or goods which are not easily identified, the average price method may be adopted. It must be pointed out, however, that this method involves more clerical labour, and is more liable to error, since every change in price involves a change in the average. This method is not suitable for the issue of the finished parts of goods, since they should be issued in the order in which they are made, and it is undesirable to introduce further variables into their cost.

Conservative manufacturers sometimes go to the extreme of issuing goods at the original purchase price of the highest priced stock; but this is not advisable, as it will generally mean either that estimates are too high to secure contracts, or that complicated adjustments must be made in framing the estimates.

It must be emphasised that goods purchased for specific contracts or jobs should invariably be priced out at the actual cost price, irrespective of the prices used at the time for issuing similar goods to ordinary contracts, since the estimate was based on the cost of the specific goods in question.

Stock-taking.—Theoretically, if the store records are accurate, stock-taking could be dispensed with. The aggregate balances of the Bin Cards, after agreement with the balances of the Stores Ledger, should furnish the total stock in hand at any date. If a perpetual check is kept on the stock, as shown by the balances on the Bin Cards and Stores Ledger, it is possible that the total stock shown as being in hand may be more accurate than the figure arrived at by the usual stock-taking methods, especially if these methods are elastic, as they sometimes are! In practice, however, discrepancies will be disclosed by the Bin Cards due to deterioration of stores, waste in measuring, errors in recording, and the like. It is wiser, therefore, to make extensive tests of the actual contents of the bins or lockers before accepting the card records as correct.

II. Cost Accounts.

There is no necessity in these days to emphasise the importance of cost accounts, either from the manufacturer's or the examinee's point of view. Present competitive conditions make it imperative that accurate and reliable accounts should be available showing not only the financial results of each trading period for a business as a whole,

but also the extent to which each unit—be it article, job, contract, department, process, or service—that contributes to make up the aggregate turnover of the business is separately responsible for those results. Manufacturing businesses, in particular, have now, with few exceptions, devised costing systems that enable the management to determine with substantial accuracy the cost of every article manufactured, and, indeed, of every separate process incidental to their manufacture. The changed conditions and the disturbing price fluctuations that have hampered post-war manufacture have rendered pre-war costings useless for present-day purposes, and at the same time have made it both more difficult and more imperative to ascertain what the current costs of manufacture actually are.

It cannot be over-emphasised, however, that cost accounting is essentially the same in principle as ordinary accounting, except that it aims at "accounting for units." For that reason it is seldom practicable to incorporate the cost accounts in the general system of double-entry book-keeping, since to attempt to do so would necessarily involve the disappearance of many of the nominal account totals which are required for the preparation of the financial accounts at the end of the trading period. It is necessary, therefore, to instal a separate system of double-entry accounts working side by side and capable of approximate reconciliation with the financial books proper. Absolute exactitude is scarcely possible in the majority of cases, since the time and trouble necessary to allocate the multitude of small expenses incurred in any manufacture would defeat the desired object, as will be seen later.

Definition.—By cost accounting is meant a specialised application of the general principles of accounting in order to ascertain the cost of producing and marketing any unit of manufacture, or of carrying out any particluar job or contract. By "cost" is meant all expenditure that can properly be allocated to the production of the unit, or to the job or contract undertaken.

Principles of Costing.—In the space available in a general text-book it is possible only to outline generally the main principles involved in the ascertainment of costs. But, because these principles are general, once they have been learned, they can be applied to any business, provided that due allowance is made for technical variations. Moreover, in many cases it is found in practice that no two businesses, even in the same trade, will require *exactly* the same system. Some differences in application are always necessary, because the precise lines of the costing system must be adapted to the business and not the business to the system. Again, from the examinee's point of view, nothing but a knowledge of general principles can in fairness be expected of him.

Advantages of Costing.—An intelligently planned costing system affords the following advantages :—

(1) It shows the actual cost of production of each unit of manufacture, or the cost of running each department of the business, thus enabling selling prices to be fixed with due regard to those costs. It provides an analysis and classification of costs, and other statistics, all of which will be of the greatest assistance when budgetting for future requirements, or deciding policy, or increasing production.

(2) It provides exact data for estimating and tendering, and enables the cost for similar jobs or repeat orders to be adjusted in accordance with known variations in current expenses and conditions, and so places competition on a rational basis.

(3) It enables comparisons to be made between one manufacturing period and another; between the costs of different methods of manufacture; and shows the variations in cost resulting from the employment of different kinds of material or classes of labour.

(4) It reveals the effect upon production of an increase in wages, or a reduction of working hours.

(5) It discloses weak points in the factory system, e.g. inefficient or extravagant processes, unremunerative branches, departments, or manufactured articles. Businesses have been ruined by large increases in turnover in one particular department or product, previously sold in relatively small quantities, but always at a loss that is hidden from view by high profits made in other departments, or on other lines of goods.

(6) It affords a check on the use of material, stores and labour; exposes waste of time and effort; prevents losses of material by theft, deterioration, etc.; shows up inefficient workmanship and incapable management; and suggests directions in which economy can be effected, and the plant and machinery be used to the utmost advantage.

(7) It shows the cost and value of work in progress.

(8) It provides valuable data for fixing methods of remunerating labour and for regulating buying; and finally

(9) Shows the return to the business for a given expenditure, the cost per unit to be added for new capital expenditure, and affords workable estimates of the probable effect of the introduction of new machinery and the like.

Systems of Cost Accounting.—The student who desires to specialise in the subject has a wide range of text-books at his command, most of them dealing with one or other of the systems in use as applied to a particular trade. The general student cannot, of course, be expected to be familiar with the requirements of particular trades, but he must be conversant with fundamental principles. Below are set out the usual "types" into which costing systems are grouped, but it must be noted that in any one business, several or all of the types may be used in different departments or processes, e.g. it may be possible and necessary to allocate all expenses in the first place to departments, and then in each department to employ another type or types, according to the stage of manufacture. The multitude of systems advocated

is apt to confuse the student, and he is advised to confine himself in the first instance to general principles such as are here enunciated.

Terminal, Job, or Contract Costing.—This system is applicable where definite contracts are entered into (e.g. Engineering, Building, Contracting, etc.), each contract being costed to its conclusion by the careful analysis of every expense of material and labour, and the attachment of a proper proportion of the shop or works Oncost expenses. The cost is then comparable with the price received. If absolute accuracy were attainable, the aggregate for the whole of the accounts should agree with the Profit and Loss Account, but in practice there will always be a margin of error, from causes which will be mentioned later.

Single, or Output Costing.—This system is applicable where there is a natural or standard unit of output. The cost is arrived at by dividing the total cost for a period, or batch, etc., by the number of units produced. The system is suitable for Collieries, Mines, Breweries, Quarries, etc., the unit being per ton, per barrel, etc.

Process Costing.—This is applied to undertakings where materials are converted by passing through several stages of manufacture, usually giving more or less valuable by-products at various stages, e.g. Chemical Industries, Tanneries, Gas Works, etc.

Operating or Working Costing.—This system is applied where the product is a service rather than a manufactured article, and the ordinary books of account contain, in themselves, the data necessary for costing the unit concerned. Railways, Tramways, etc., are examples in point, the unit being per passenger or per car mile. The system is sometimes employed in the case of Gas and Electric Light Works, where the subsequent processing of by-products is not done in the works.

Multiple Costing.—This method is applicable " where a number of products are involved bearing little or no relation to one another in cost or selling price, and in which the manufacture is organised to a high degree of specialisation in parts." It is adaptable to the manufacture of Cycles, Boots, Small Tools, Furniture, Hosiery, Toys, etc., the parts of which are standardised to a high degree, involving constant and regular processes and repetition work. Each process or operation must be costed separately so as to arrive at the total cost for a given number of articles.

Departmental Costing.—This type has been left till last, since, in the majority of instances, as mentioned above, it is merely a preliminary allocation, from which the output of each department is costed by some other type. Where it is difficult or impossible to obtain units suitable for calculation (e.g. in Retail Stores), the department may be treated as a whole, and periodical comparisons can be made with prior periods and with similar departments.

It must be realised that to a great extent the above divisions are arbitrary, since the system must be fitted to the works or business.

Devising a System.—The first step towards the inauguration of a successful costing system (after having induced the manufacturer to agree to the organisation of his works so as to afford the necessary data) is to enlist the sympathies of the works manager and his staff. The usefulness and expense of the system are dependent upon the size and organisation of the business, and a knowledge of technical detail is essential to success. The accountant must collaborate with the technical staff, and familiarise himself with the processes of manufacture, and the routine from which the costing data must eventually be collected.

Costing Terms Defined.

(*a*) *Prime Cost* (*Flat Cost*).—This is made up of the materials, labour and expenses directly chargeable to a unit, job, contract, or particular service.

(*b*) *Oncost*.—In all manufacturing businesses certain indirect expenditure is inevitable. This expenditure is known as Oncost. For example, the wages of store-keepers, time-keepers, clerks, supervision expenses, and the like have no direct relation to any particular job or process, and do not rise and fall uniformly with the output. Expenditure of this nature must, however, be allocated, as it necessarily enters into all estimates and costing results. Oncost, therefore, represents the proportion which each unit, job, contract, or particular service must bear of the indirect, overhead, fixed, or establishment charges that cannot be directly allocated to any definite item of production—in short, all the expenses of a business other than direct labour, materials and expenses. These expenses are frequently divided into "Works Oncost" and "Office Oncost." The former comprises all overhead expenses up to the point when the unit leaves the factory; the latter comprises all subsequent expenses. Office Oncost, again, is sometimes divided as between selling and distributing. Broadly stated, the direct element of cost = Prime Cost, and the indirect element = Oncost.

(*c*) *Total* (*Gross Production*) *Cost*.—This is made up of Prime Cost + Oncost. *Selling Price* consists of Total Cost + Profit. *Job Costing* is simply a method of charging costs against individual jobs, i.e. direct labour and materials with an added percentage for Oncost. Few businesses are suitable for this system.

(*d*) *Direct Labour*.—Labour directly expended in producing a unit is termed *Direct Labour*; labour expended upon services general to the whole factory is termed *Indirect Labour*. The same sub-divisions are frequently applied to materials and expenses.

(*e*) *Labour Hours*.—The aggregate number of hours worked by the whole labour staff.

Elements of Costs.—Broadly speaking, the costing system of any business is in reality an analysis of the Manufacturing or Trading and Profit and Loss Accounts. The debits appearing in these accounts

resolve themselves into: (*a*) Items which are directly related to and chargeable against the articles manufactured (i.e. direct wages, materials and expenses); (*b*) expenses that cannot be directly charged against the articles manufactured (i.e. indirect wages and expenses).

The student should realise that, at the best, cost accounts can only closely approximate to accuracy. They must of necessity include an element of estimate, and to the extent that they do they are less exact than the financial accounts.

So far as is practicable, all expense items are charged direct to the unit selected for costing purposes. It would be possible, with the expenditure of sufficient time and care in analysis, to allocate directly the majority of expenses, but the time and expense necessary for such meticulous analysis would rob the result of its value and far from justify the small margin of increased accuracy attained thereby. It is therefore better to speak of expenses as being "conveniently attachable."

A typical costing system will deal with :—

(*a*) Labour directly and conveniently attachable to the unit.

(*b*) Materials directly and conveniently attachable to the unit.

(*c*) Expenses and disbursements directly and conveniently attachable to the unit (e.g. travelling expenses of workmen engaged on a distant contract; plant bought for use on a specific job, etc.).

The above (*a*), (*b*) and (*c*) make up the *Prime Cost* of the unit.

(*d*) Expenses which cannot be directly and conveniently attached, i.e. Works and Office Oncosts.

Works Oncost is made up of indirect wages paid to cranemen, boys, store-keepers, yardmen, and other general labourers; rent of works; depreciation of machinery; expense of general stores (oil, waste, repairs, etc., and other factory expenses). This Works Oncost must be apportioned equitably over the units produced. Prime Cost plus Works Oncost is termed Works Cost, and if to this Works Cost we add a due percentage of the total office and administrative expenses (= Office Oncost) we then arrive at the Cost of Production. Cost of Production plus selling and delivery charges gives the total Cost of Output available for sale. Some authorities apply the terms "Cost of Production" or "Net Cost" as being synonymous with what is here termed "Works Cost," and use the term "Gross Cost" to signify "Works Cost" plus "Office Oncost."

Prime Cost will, of course, vary with the output, but Oncost is composed largely of charges that remain more or less fixed. The components of cost must now be dealt with in detail.

Labour.—The correct booking of time is a first essential of accurate costing. Wages may be paid on the time system (hourly, daily, weekly), or on the piece-work system, or the bonus system. Indirect labour is paid for almost invariably on a time basis. Piece-work is largely

employed for direct labour. It may be "ordinary" (i.e. so much per unit completed), or "contract," i.e. a fixed price for a given job or quantity paid to a contracting foreman who acts for the men under him. Where the time system is in operation, each workman will be booked into and out of the works by a time-keeper or by one of the mechanical clocking-in machines (e.g. the Gledhill Time Recorders) now extensively used. The principle of these machines is that the workman inserts his numbered key, or card in a clock, which records the time on a sheet or on the card, as the case may be. The older system of entering up each man's time in a time book is unreliable, cumbersome, and time-wasting.

Usually, only the times of entering and leaving the works will be recorded on the cards, although it is practicable and advisable in some cases to have additional clocks for each department, and for each large job or contract. In any case, where numerous jobs are passing through the works, it will be necessary for time sheets to be kept by the foreman for each man, or by each worker individually, to record the time spent and the work done, with the appropriate job number. The sheet made up for each man must be compared with his total time in the works as recorded by the clock, and any discrepancies must be immediately investigated.

The time sheets must be priced out at the worker's effective rate, and then analysed over the respective jobs, on a *Labour Abstract* (*Abstract of Wages*). So far as possible the wages will be attached to specific jobs, but there will be a certain proportion which cannot conveniently be so attached. This must be extended into the indirect wages column to be dealt with through the Oncost. Even where the piece-work system is in operation, it will still be necessary to keep time sheets for inside workers, as time enters directly into the cost. If one man takes twice as long to do a certain piece of work as his neighbour, a greater proportion of Oncost will be attachable, since the majority of the overhead charges are irrespective of output. A system which is growing in favour is to provide the men with a "job ticket" for each particular job. These tickets are collected daily, and a wages abstract is produced from them.

Bonus or *Premium Systems* are also growing in favour, but detailed explanation of these somewhat complicated systems cannot be entered into here. The principle of these systems is that a certain standard time is fixed for an operation, for which the worker is paid at the usual agreed rate. If the worker completes the work in less than the standard time, he is paid a percentage of the saving effected, or a premium equal to the percentage of time saved. These systems are more fully dealt with in *Accounting*, by the present author. In some instances a standard output for the works is fixed; if this output is exceeded, a *collective bonus* is paid to all the workers. In others a *High Wage Rate* is adopted and no bonus is paid, but the output

must be maintained. Specimens of time sheets, etc., will be found in the author's *Accounting*. Wages paid under piece-work and bonus systems are summarised in the same manner as time wages.

The total of the Labour Abstract should be agreed with the pay-roll for the week, after which the postings may be made. Debits will be put through to the individual job accounts, to standing orders, etc., and to Indirect Wages Account, the credits being to Total Accounts appropriately named.

Materials.—It has already been pointed out that discrepancies will probably arise in accounting for materials, but they should be within narrow and ascertainable limits. The system of receipt and issue of goods recommended above gives all the necessary data for the costing records. The requisitions, credit slips, and transfer slips must be analysed out over jobs, as in the case of wages, on a *Materials Abstract*, and the postings entered up in a similar manner to that advised above for wages, including the Total Accounts. Materials bought for specific jobs should invariably pass through stores in the usual way. Indirect materials (i.e. materials which cannot be conveniently allocated to any specific job, such as oil, waste, etc.) must be dealt with in a similar manner to indirect wages.

Oncost.—In the case of Single Costs, the amount of Oncost attachable to each unit is readily arrived at by dividing the total indirect expenses of the period over the number of units produced, e.g. per barrel of beer, per ton of coal, etc. In other cases, Oncost is more difficult to distribute, and must to an extent be approximately estimated. The following is an outline of the more usual methods adopted :—

Percentage Method.—This can be employed where there is little variation in the rate of wages paid, and the machines used are of uniform cost and construction ; and also in cases where the work does not vary, or varies only within narrow limits. The percentage may be calculated : (*a*) On wages in general, or at different rates for departments or classes of operation ; (*b*) on materials ; (*c*) on Prime Cost ; or (*d*) on some differential basis combining two or more of the above methods according to the facts of the particular case, and the most constant factor in production. It will be clear that each case must be treated on its merits when we consider that two workmen, A and B, may be working side by side, each doing equally skilled work, but, while A is working on materials costing £100, B is working materials costing 10s. In circumstances of that kind, if the Oncost is allocated as a percentage on Prime Cost, and the wages earned on the jobs are in each case £5, it will be hopelessly inaccurate to load B's job with $\frac{5\frac{1}{2}}{105}$ths as much Oncost as is attachable to A's job. In the case quoted, other factors being the same, the necessities would probably be met by the

addition of a proper percentage on wages. To give effect to variations in the skill of workmen, efficiency hours may be taken for the allocation of the Oncost. The Prime Cost method is little used, and is applicable only in cases where the material worked is uniform throughout and forms the predominant element of cost.

Productive-Hour Method.—This is based upon a rate per hour of direct time. Where either the rate of wages, or the nature of the work varies, a general or departmental rate may be adopted, based on the actual productive hours taken to execute a certain task or operation. Direct hand-labour hours are sometimes used for that class of work, and total direct labour for the balance of the costing. The total Oncost figure divided by the total direct-labour hours gives the Oncost rate per hour. The time sheets will give particulars of the man-hours worked.

Machine-Hour Method.—Under this method the cost of operating the machine is ascertained, and is embodied in a machine-hour rate based upon the time the machine is at work. This method is practically essential in the heavy trades, and must be employed where machinery is the predominant factor in production, and there is a wide difference in the cost of the machines employed and the power required to run them. Rates are calculated for each machine or group of machines. The expenses generally included in the machine-hour rate consist of rent for the space occupied by the machine, rates, insurance, depreciation, repairs, oil, cleaning materials, and all the like expenses of running the machine. The total of these expenses for the period the machine is to run, divided by the estimated running hours the machine is to work, will give the machine-hour rate. Needless to say, a period of average trading must be selected and not one of depression. The whole of the Oncost may not be fairly distributable where this method is employed, and some part of the charge may have to be apportioned on a different basis. The time sheets, again, will furnish particulars of the number of hours that each machine has run. The total expenditure on the machine, divided by the number of hours it has been worked, will give the machine-hour rate. The " expenditure on the machine " covers labour, power used, depreciation, repairs, etc., to which are sometimes added rent, rates, etc., based upon the space occupied by the machine.

Entries in the Cost Books.—The debits to the individual accounts in the cost books, by whatever method adopted, may be made weekly along with the labour debit, or they may be debited when the job has been completed. If the latter method is employed, care must be taken at balancing periods to make the adjustment for the Oncost on work in progress. The totals should be credited to a Total Account, which should, at regular and frequent intervals, be compared with the total of the actual expenses as recorded in the financial books, any discrepancies being investigated, and the rates adjusted at once, if necessary.

Office and Administrative Oncosts.—This charge is not usually apportioned on the above methods, but is computed as a percentage on Works Cost. Sometimes it is apportioned on the basis of turnover However, the facts of each business must be considered separately, and the most suitable method adopted to meet those facts.

Primary (Direct) Allocations.—Since the object of allocating Oncost is to approximate costing to actual conditions, so far as possible, the necessity for approximation should be limited. Wherever possible, care should be taken to allocate expenses over the individual shops and departments, so that the limits of error should be reduced. Rent, rates, taxes, insurance, for example, may be apportioned on the basis of the number of square feet occupied, or on the cubic capacity of the space occupied; lighting, according to the number of points used; heating by cubic capacity; power by metered consumption, and so on. When all the expenses that can be ear-marked have been allocated to the respective shops or departments, there remain the general Oncost expenses, and these must be apportioned on the most suitable basis in the circumstances.

Care must be taken, in fixing rates, to make adjustments for expenses that do not attach equally over all departments or jobs. There may, for example, in one department, be a preponderance of unskilled labour; in another, skilled men only may be employed, with a boy for odd jobs. As a general rule, unskilled workmen will be slower than skilled, and they will tend to spoil more materials and tools, and so require more supervision. More Oncost will, therefore, be attachable to unskilled than to skilled labour.

It will be obvious that to cost a job or process *after* completion would be so to delay the costing as to render it useless. It is necessary, therefore, to base costing figures upon *past* experience, and to make adjustments from time to time in order to meet known alterations in conditions and circumstances.

The Cost Ledger.—This is the nominal ledger of the costing system, and it must be kept on complete double-entry principles. For this purpose Total Accounts are employed, as explained above; direct wages, purchases, stores, etc., being debited in detail to the particular cost account concerned, and credited to accounts headed Direct Wages, Direct Materials, Total Accounts, etc.

Total Accounts.—It remains to deal with these accounts at the end of the period. If Oncost has been debited periodically to individual job accounts, it will be seen, at the end of the accounting period, that the Oncost attachable to all work in progress has been apportioned. If Oncost is debited only to completed jobs, the appropriate Oncost attachable to all work in progress should be carried down on an Oncost Suspense Account.

The respective Total Accounts thus arrived at should now be compared with the actual expense accounts for the same items as shown

in the financial books. If serious differences appear, they must be investigated, and, if necessary, adjusted to the Job Accounts. All differences, however small, should be noted in order to avoid similar discrepancies in the future, and, if necessary, the basis of allocating Oncost or the pricing out of materials and wages must be amended.

The Total Accounts have now fulfilled their function, and can be closed off to Cost Ledger Control Account. Completed jobs can also be closed off to this account. Under the first method there will then remain open only Uncompleted Job Accounts representing work in progress (Dr.), and the Cost Ledger Account (Cr.), which should agree; under the second method Uncompleted Job Accounts are stated only at prime cost. The addition of the Oncost Suspense Account gives the value of work in progress, and this should agree with the Cost Ledger Control Account balance.

Statistics can be prepared of the cost of completed jobs for comparisons and future use. Some authorities prefer to incorporate selling prices and profits or losses in the Cost Ledger, opening appropriate Control Accounts. In that case, the Control Accounts are closed off to a Manufacturing Account, which is reversed as compared with the ordinary financial account, so as to show the result of the period's manufacture as a whole. There seems little advantage in this method. It is a duplication of labour, and the Manufacturing Account should, as a general rule, show cost and not be concerned with marketing. All the useful information should be tabulated in a more readily accessible and comparable manner than is possible in the Cost Ledger, in which, perforce, there must be a separate opening for each job. This, however, is a question that must be decided according to personal predilections and the special requirements of the particular business.

By-products.

In cases where manufacture involves a succession of processes, one of the chief accounting difficulties arises in connection with the by-products of manufacture. In the course of manufacturing the article, various substances, liquids, etc., may be produced for which, at least at first, no use can be found; and trouble and expense must be incurred in getting rid of them, thus adding to the cost of manufacturing the article. This problem was very acute, for example, in the earlier history of the manufacture of soap, certain of the by-products polluting the atmosphere to such an extent that they had to be buried immediately.

But time and experiment frequently find profitable use for these hitherto waste products, and so instead of being an additional expense they become marketable products, and reduce the actual cost of the main product. In the case of soap-making, already cited, an enterprising farmer found that the by-product made good manure. He

took part of the output, until further experiment having showed that it had valuable chemical properties, chemists were found willing to pay ten times as much as the farmer for the by-product and to take the whole output. Here we have a by-product of intrinsic value, and, in some cases, of greater market value than the main product. It is clear that an attempt must be made to allocate costs equitably as between the main product and the by-product or products. Both main and by-products travel together up to the separation point, and it is the apportionment of the expenses up to this point that creates difficulty, since expenses incurred subsequent to separation can be attached to the particular product concerned.

In practice, it is found that manufacturers adopt different accounting methods for the costing of by-products. Sometimes only sales are recorded, and no attempt is made to separate the costs, or even to estimate them. It is impossible to tell by this " method " whether any profit is made on the by-products. Costs being unknown, there is no basis for fixing selling prices or for formulating manufacturing policy. But it must not be overlooked that in some small businesses little more than this can be done without incurring undue expense for clerical labour. A variation sometimes adopted is to debit the by-products with all expenses incurred after separation from the main product, proceeding otherwise in the same way. Under the first method no inventories are taken; under the second no stock sheets are prepared. In neither is any record kept of the by-product until it is sold, thus leaving a direct loophole for fraud.

Where nothing is done to the by-products after they have been separated from the main product, it is quite common, especially in small businesses, to take a daily inventory of the output, to prepare stock sheets, and to keep proper account of the movements of the by-products, crediting any realisations, as adjusted by stocks, to the main product, or to the main material entering into its manufacture. Many small gas works, for example, credit the net realisations for unworked by-products to Coal Account. No " profit " is taken on such by-products, the aim being merely to " cost " the main product.

Method of Accounting.—The above loose and incomplete methods being dismissed, a workable system of separating the costing of main and by-products may now be described. As with all costing, the principles are fixed, but the application of the principles must be adjusted to the needs of the particular business. It has been said that " all costing is approximate." That is a truism which it would be idle to attempt to refute. But there is no reason why the approximation should not be closely true to the actual facts. Under the system now suggested—it has been found to work well in practice—arbitrary values have to be assigned to the products at the point of separation one from the other, since, usually, it is impossible exactly to calculate the costs of each product. The points to be considered are: (*a*) how

high a degree of accuracy is possible, and (*b*) the relative value of the products. The arbitrary values may be calculated on one of the following bases :—

(1) At current purchasing price for the article in the same state of manufacture, or at selling price less approximate profit.

(2) Where there is a common standard, on the basis of that standard, e.g. British Thermal Unit.

(3) Where the by-product has a market value, according to that value, less the profit which would be made if the residual were manufactured independently.

(4) Where none of the above methods is applicable, then by working back from the selling price, which is often the only thing in common to all the products. For example, where, in the manufacture of a solid, there is given off a gas and a liquid, it is usually impracticable to apportion on any basis other than price.

All expenses of material, labour, and oncost up to the point of separation of the products are debited to a joint account. Subsequent expenses are debited to appropriate accounts for main and by-products. From the selling prices must be deducted the estimated profits and subsequent expenses, thus arriving at the basic figures for the purpose of apportioning the "joint" expenses.

The calculation proceeds as follows :—

Joint Account : Expenses up to the point of separation.

	£	£
Material	500	
Labour	400	
Oncost	450	
		£1,350

Subsequent expenses :

	Main Product.	First By-Product.	Second By-Product.
	£	£	£
Material	100	80	90
Labour	120	70	85
Oncost	130	50	75
	£350	£200	£250
Selling prices	2,100	1,000	900
Deduct :			
Estimated Profit	50% 1,050	50% 500	33⅓% 300
	1,050	500	600
Subsequent expenses as above	350	200	250
Basis of apportionment of Joint Account	£700	£300	£350

The cost accounts will therefore appear as follows :—

	£	£	£	£
Process 1 (*Joint*).				
Material	500			
Labour	400			
Oncost	450			
	£1,350*	700	300	350
Process 2.				
Material, etc. (detailed above)		350	200	250
TOTAL COST		£1,050	£500	£600

* These bases would also be used for subsequent apportionments, but would be recomputed from time to time.

It will be observed that no adjustment has been made for selling and administrative charges. If these are separately oncosted, they will be deducted at the same time as the estimated profit in arriving at the basic figures for apportionment. Where the rate of profit cannot be estimated for the main product, the calculations will be made for the by-products, their basic costs will be deducted from the joint expenses, and the cost of the main product can then easily be arrived at.

Unrealised Profits Taken in Process Costing.—Where a product is put through several processes, the finished article of one process becomes the raw material of the next. It then becomes necessary to decide at what price the transfers from process to process shall be made. If bare " cost " is taken, it is obvious that in all processes after the first it is impossible to ascertain whether it is profitable to manufacture the article or not. For this reason it is advisable, from process to process, to invoice out at the current wholesale price which would have to be paid for an article in a similar state of manufacture, or at a " loaded " price approximating thereto. Particularly is this the case where some of the raw material is purchased and not obtained from a prior process. An additional advantage derived from this system is that managers know only the results of their own department, and not those of the cumulative cost as a whole. This method involves a profit (or loss) being shown on each process. If a loss, steps must be taken to reduce the cost, otherwise it may be advisable to eliminate that particular process by selling at the previous process and buying for the subsequent one. Where this method is adopted, comparisons are possible with outside costs, and commission bases for the remuneration of managers can be determined. At stock-taking times, however, adjustments are necessary in order to eliminate the unrealised profits included in the closing stocks of finished and partly manufactured goods. So far as the goods have been sold, the profits have, of course, been realised, but a reserve must be built up for the whole of the unrealised profit included in the closing stocks ; in subsequent years it will only be necessary to adjust for the increases or decreases in

stock, in exactly similar manner to that employed when making a reserve for bad and doubtful debts. A simple example of the adjustment for the first year is appended :—

Process 1.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Purchase of Raw Materials	600	0	0	By Process 2 (Wholesale price)	800	0	0
Less Closing Stock ..	200	0	0				
	400	0	0				
,, Labour and Oncost	300	0	0				
,, Profit (to Profit and Loss Account)	100	0	0				
	£800	0	0		£800	0	0

Process 2.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Process 1	800	0	0	By Finished Goods	960	0	0
Less Stock	320	0	0				
	480	0	0				
,, Labour and Oncost . ..	400	0	0				
,, Profit (to Profit and Loss Account)	80	0	0				
	£960	0	0		£960	0	0

Finished Goods.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Process 2	960	0	0	By Trading Account	720	0	0
Less Stock	240	0	0				
	£720	0	0		£720	0	0

Trading Account.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Finished Goods	720	0	0	By Sales	1,080	0	0
,, Apparent Gross Profit ..	360	0	0				
£	1,080	0	0	£	1,080	0	0

Profit and Loss Account.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Reserves for unrealised Profits :—				By Apparent Gross Profit :—			
Process 2 (*a*)	40	0	0	Finished Goods	360	0	0
Finished Goods (*b*) ..	35	0	0	Process 1	100	0	0
				Process 2	80	0	0

(*a*) On the materials issued from Process 1 to Process 2 a profit of $\frac{1}{8}$th was taken. There is still £320 of these goods in stock, on which an unrealised profit has been taken. This amounts to $\frac{1}{8}$th of £320 = £40.

(*b*) The Profit taken in Process 2 is $\frac{1}{12}$th.

Therefore the unrealised profit in Finished Goods *re* Process 2 is .. .. $\frac{240}{12} = 20$

Of the output (at invoice price) of Process 2, $\frac{1}{2}$ is represented by output of Process 1, on which a profit of $\frac{1}{8}$th has been taken, therefore the reserve *re* Process 1 is $\frac{1}{8}$th of $\frac{1}{2}$ of 240 15

£35

In subsequent periods, if the stock in any Process, etc., has increased, the reserve must be correspondingly increased. If the stock has decreased, this means that the profit has been realised, and the reserve can be decreased.

In the Balance Sheet the Stocks will appear as follows :—

		£	£	£
Finished Goods		240		
Less Reserve for unrealised profit		35		
			205	
Raw Materials and Partly Manufactured Goods—Process 1		200		
Process 2	£320			
Less Reserve	40			
		280		
			480	
				685

If the market price should happen to be less in any case, a further reserve will be necessary. In practice, work in progress must also be adjusted.

COST SHEETS.

BREWERY COST SHEET.

Brewing No. .... Quality .... Date ....

Quantity.	Materials Used.	Stores Book Folio.	Price. £	s.	d.	£	s.	d.	Notes.
	Malt—								
	British								
	Foreign								Barrels—
	Sugar: Details								Brewed ..
	Hops. Details								Racked ..
	Preservatives: Details								
	Other materials—								
	Details								Production—
	Duty								Barrels at a cost of per barrel.
	Less Grains sold								
	Spent hops sold ..								
	Sundries sold ..								
					£				

NOTE.—After arriving at the cost of production, as shown in this section of the account, wages, water, fuel, and overhead charges would be added to complete the costing.

Cost Sheets—*continued.*

COST OF CONTRACTS IN HAND, DECEMBER 31, 19..

Builders' Engineer.

No. of Contract.	Name of Contract.	Cost brought forward from last Cost Sheet.			Iron, Steel.			Scrap Iron, etc.			Stores Used.			Concrete, Bricks, Building Material.			Nuts, Bolts, Rivets.			Paints, Varnish, Grease.			Direct Wages		
		£	s.	d.	£	s	d	£	s.	d	£	s.	d.	£	s.	d.	£	s	d.	£	s.	d.	£	s.	d.

COST OF CONTRACTS IN HAND, DECEMBER 31, 19..—*continued.*

Indirect Wages			Travelling and Incidentals.			Fitters' Wages.			Carriage, Freight, Insurance.			Estimated Cost of Completing Contract.			Total Cost.			Contract Price.			Profit.			Loss.			Remarks.
£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	

COST SHEETS—*continued.*

MOTOR-CARS.

COST OF CHASSIS.

	£	s.	d.	£	s.	d.
Purchases—						
Finished Parts						
Stores						
Wages—						
Machine-room						
Founders						
Erecting						
Sundry						
Works Oncost—						
Rent, Rates, etc.						
Fuel, Heating and Lighting						
Salaries and Indirect Wages						
Repairs, Depreciation, etc.						
Office Oncost—						
Office Rent, Rates, etc.						
Salaries						
Advertising						
Travellers' Salaries and Commission ..						
Discounts and Allowances						
	Total Cost..			£		

EXAMINATION QUESTIONS.

1. Carefully define the word "Stores" as employed in Costing systems. Describe in detail the method of charging out Stores, including raw material and finished parts, in Costing systems. Should the Stores be charged out at cost or at current market prices? In the latter case, how do you propose to reconcile your Stores Account in the Costing System with your Stock Account in your financial statement? (*Incorporated Accountants.*)

2. Give rulings of any books, or forms, which you recommend for the record of the above receipt and issue of stores, and make the necessary entries therein. (*London Chamber Commerce.*)

3. Select a manufacturing business with which you are familiar, and prepare a brief set of rules for the guidance of the store-keeper.

Submit rulings of *two only* of the books or documents you recommend. (*Chartered Accountants.*)

4. Sketch a Report showing the method that you would advise to stop an obvious leakage in the stock of any business with which you may be acquainted; such method to record the charge to and issue from Stores of Goods purchased. (*Incorporated Secretaries.*)

5. Give a ruling of a Materials Abstract Book, suitable for employment in cases where purchases are made (*a*) for specific jobs, (*b*) on Capital Account under three headings (Plant, Loose Tools and Sundries). (*Royal Society Arts.*)

6. Give suitable rulings for any three of the following: Order Book; Stores Issued Book; Stores Delivery Note; Stores Requisition Note; Stores Ledger Account; Departmental Wages Journal; Cost Ledger Account. (*Incorporated Accountants.*)

7. In charging out of Stores the basis of the pricing of issues is a contentious point. Give the relative merits of two methods. (*Incorporated Accountants.*)

8. Describe three different bases upon which wages are paid in manufacturing businesses, and submit a ruling for a weekly time sheet suitable for use in any business you may select. (*Royal Society Arts.*)

9. In a manufacturing business, where all labour is paid on a time basis, describe how you would (*a*) check the time worked by the men, and (*b*) deal (for Costing purposes) with the wages paid.

Submit the ruling of the time sheet you would issue to the workmen. (*Royal Society Arts.*)

10. What is meant by a machine-hour rate, and how is it arrived at? (*Incorporated Accountants.*)

11. A manufacturer wishes to inaugurate a Costing system by means of which the Overhead or Oncost expenses may be presented as a percentage on the direct labour or on the total labour employed.

Discuss the principle involved and criticise the method suggested. (*Incorporated Accountants.*)

12. Briefly describe a manufacturing business with which you are familiar, and differentiate between the wages paid for: (*a*) Direct Labour; (*b*) Indirect Labour; and (*c*) Casual Labour. State how you would allocate the several classes of labour you define, when preparing the Costing records of the undertaking. (*Chartered Accountants.*)

13. Explain the difference between Works Oncost and Office Oncost. Indicate one or more ways in which such costs can be applied. (*Incorporated Secretaries.*)

14. Give a suitable ruling for a Columnar Cost Ledger, showing how the total cost of any work undertaken is arrived at, insert *pro forma* entries, and state what method you adopt of allocating indirect charges, and your reasons for so doing. (*Chartered Accountants.*)

15. What are the principles of Process Cost Accounts? Illustrate your answer by means of *pro forma* accounts of a manufacturing business to which Process Cost Accounts could apply with advantage. (*Chartered Accountants.*)

16. From the following figures taken from the books of the Alpha Manufacturing Company show in convenient form the Costing results for the two years:—

1st Year: Materials, £50,000; Wages, £30,000; Indirect Expenses, £10,000; Sales, £99,000.

2nd Year: The cost of Materials and Wages had increased by 25 %, the Indirect Expenses by 5 %, and the Sales by £28,075.

(*Institute of Book-keepers.*)

17. You have been asked by a manufacturer to devise a system of Cost Accounts. Select a manufacturing business and state: (*a*) The various items of expense which you would include under the heading "Oncost"; (*b*) the source from which you would obtain the necessary figures upon inaugurating the Costing system; (*c*) the basis upon which you would allocate the Oncost expenses. (*London Chamber Commerce.*)

18. The weekly wages total of a factory, making sewing-machines, is analysed under the following heads: (1) Productive Labour. (2) Engine-

room. (3) Repairs—(*a*) Engine-room Plant; (*b*) Belts, Pulleys, Shafting; (*c*) Lighting; (*d*) Machinery; (*e*) Buildings. (4) Store-keepers and Factory Clerical. (5) Watchman and Guard. (6) Factory, Executive and Supervision. (7) Office—(*a*) Orders and Stores; (*b*) Costing; (*c*) General. (8) Administrative. Select any four of these and state how they should be dealt with in the Costs. (*Chartered Accountants.*)

19. A manufacturer, whose business is divided into five departments, each situated in a different part of the same building, and each turning out a distinct class of article, wishes to ascertain the approximate cost of each type of article over a year.

Detailed records of stores and departmental wages books are kept.

State on what basis you would apportion the following items appearing in the Profit and Loss Account, and what additional information (not appearing in the ordinary books of account) would be necessary to enable this to be done: (*a*) Carriage inwards; (*b*) Rent; (*c*) Machinery Depreciation; (*d*) Office Salaries; (*e*) Heating and Lighting. (*London Chamber Commerce.*)

20. After charging up wages, material, and certain other expenses to the particular works in connection with which such expenditure was incurred, the books of a manufacturing company show additional expenditure under the following heads:—

Salaries—Works Engineers and Managers, £5,500; Travellers, £2,500; Administrative, £8,000. Rates, £2,000. Rent, £4,000. Commission, fares, and allowances to travellers, £2,500. Carriage outwards, £650. Directors' Fees, £1,000. Stationery—Works, £125. Stationery and Printing—Office, £375. Postages and Telegrams, £160. Depreciation—Buildings, £500; Plant and Machinery, £950. Fire Insurance, £350. Advertising and Catalogues, £1,250. Carriage inwards, £120.

Place each of these items under one of the following charge headings: (*a*) Works; (*b*) Selling and Distributing; (*c*) Administrative; (*d*) General.

Of the rates and rent one-eighth is in connection with the Office. (*Incorporated Accountants.*)

21. The Trading and Profit and Loss Accounts of the Baxter Trading Company, Ltd., who deal in gramophones sold at £20 each net, for the year ended December 31, 19.., are as follows:—

TRADING ACCOUNT.

		£			£
Jan. 1.	To Stock	2,000	Dec. 31.	By Sales	15,000
Dec. 31.	„ Materials ..	3,875		„ Stock	1,000
	„ Wages	6,000			
	„ Gross Profit ..	4,125			
		£16,000			£16,000

PROFIT AND LOSS ACCOUNT

		£			£
Dec. 31.	To General Expenses ..	1,500	Dec. 31.	By Gross Profits ..	4,125
	„ Depreciation	750			
	„ Directors' Remuneration	375			
	„ Net Profit ..	1,500			
		£4,125			£4,125

Prepare a Cost Sheet showing the cost of production per unit. (*Incorporated Secretaries.*)

22. A pencil manufacturer makes two types of pencils, "Black" and "Coloured." They undergo two processes, factory and finishing. Raw materials used in the factory and general expenses are apportioned in the ratio of output of each class; the output in 1918 was 24,000 gross Black and 8,400 gross Coloured; the actual cost of labour for each process is ascertained; "other charges" for each processes are apportioned in the same ratio as labour for that process; finishing materials are apportioned in the ratio of finishing labour. From the following particulars prepare a statement of the cost per gross, in shillings and pence, of each item and each process in the cost of manufacture; and the profit per gross if the selling prices are £1 and 19s. respectively.

Factory Raw Materials—Opening Stock, £3,680; Purchases, £10,710; Closing Stock, £4,940. Factory Wages—Black, £4,200; Coloured, £1,365. Factory Charges, £3,710. Finishing Wages—Black, £2,000; Coloured, £560. Finishing Raw Materials—Opening Stock, £720; Purchases, £3,370; Closing Stock, £890. Finishing Charges, £1,920. General Expenses, £3,645.

(*Chartered Accountants.*)

23. From the following particulars you are required to show: (*a*) The profit or loss per ton on each class of the commodity; (*b*) the average cost of production per ton of the whole output; (*c*) the average selling price per ton of the whole output.

	Production in Tons.	Total Costs per Ton.			Selling Price per Ton.		
		£	s.	d.	£	s.	d.
Common	15,087	1	9	10	1	13	6
Block	3,830	2	1	9	2	16	10
Fishery	3,049	1	18	3	1	16	6
Packet	120	10	0	3	9	3	0
	22,086						

(*Incorporated Accountants.*)

CHAPTER XVI

HIRE-PURCHASE ACCOUNTS

IN these days a large number of commodities change hands under a "hire-purchase" agreement, or on "payment by instalment" terms.

Hire-Purchase.—Under this system, the hire-purchaser enters into an agreement with the hire-trader or hire-seller, whereby the hire-purchaser undertakes to pay an agreed number of periodical instalments as hire of the articles which he desires to possess, on the understanding that, if and when all the instalments are duly paid, the subject-matter of the agreement shall become his absolute property. Under some agreements of this kind the hirer may return the goods. If he does return the goods, he forfeits the instalments he has paid. As a general rule the hire-trader cannot terminate the contract. Until the whole of the instalments have been paid, the goods remain the property of the hire-trader, and, if default is made in paying the instalments, he can demand their return.

From the book-keeping point of view, it is important to realise that in such a transaction there is no *sale*. The only book debt created is a claim for the unpaid instalments, which lapses if the goods are returned, or reclaimed, owing to the hire-purchaser's default in paying the instalments. The proper treatment to be followed by the hire-seller is to ascertain the cost of the goods out on hire, and to deal with them as stock.

This treatment may be simply illustrated as follows :—

HIRE-PURCHASE TRADING ACCOUNT.

Three Articles on Hire. Cost, £120. Payable in three annual instalments of £20 each article.

DR. | CR.

	£	s.	d.		£	s.	d.
Cost of Articles ..	120	0	0	Cash, First Year's Instalments.. ..	60	0	0
Balance, being Gross Profit	20	0	0	Value of Stock, i.e. Cost, £120, *less* £40, to reduce value to cost price	80	0	0
	£140	0	0		£140	0	0

The hire-purchaser's position is that he is acquiring an asset at a total cost in excess of the cash-down price. Moreover, the asset is not his legal property until all the instalments have been paid. How is he to treat the instalments in his books? Assuming that it is his intention to complete the agreement, he is justified in charging the asset account, headed, e.g., by some such caption as "Motor Lorries in Course of Hire-Purchase," with the cash-down price, and treating the balance as cost of hire or as interest. But, in compiling his Balance Sheet, he realises that the balance due to the hire-seller is not an immediate liability, and that the balance on the Asset Account may become a fictitious asset. He, therefore, deducts the credit balance of the hire-seller's account from the debit balance of the Asset Account. Further, he remembers that, whatever the method of payment, the asset will depreciate in value.

Payment by Instalment Method.—A contract of sale on the instalment payment system is an *out-and-out sale* under agreement that the purchase price shall be discharged by a definite number of payments made at definite dates. Possession and legal ownership of the goods pass to the purchaser immediately he signs the agreement and pays the first instalment. The vendor has, then, no rights over the goods, but he can, of course, sue the purchaser for any instalment that he may fail to pay. Thus, from the vendor's point of view, the transaction is a conversion of stock into a book debt payable by instalments; from the purchaser's point of view it is the acquirement of an asset, the purchase price of which is a debt due from him. Here, again, whether the debt is paid or not, the asset will depreciate.

Analysis of the Purchase Price.—It is clear that the price to be paid for the goods under either of the above systems of purchase is greater than the cash-down price. The price may be said to comprise three elements: (*a*) The cash-down price, plus (*b*) interest on the unpaid portion of that price, plus (*c*) an addition, or loading to cover the risk of default. Although, in the case of hire-purchase, the vendor is secured to the extent that he can take possession of the goods should the hire-purchaser default in his payments, yet, even so, there is the risk that the goods may be dealt with in fraud of the legal owner. In any case, should default be made, the goods will be second-hand, even if they are not actually damaged, and so of less value than they were at the time of transfer. It follows, therefore, that the whole hire-purchase, or deferred payment, price cannot be credited by the vendor to his Trading Account; and that from the purchaser's standpoint the periodical payments which he is under obligation to make comprise both capital and revenue items.

Treatment in Books of Account.

Seller's Books.—Broadly speaking, the seller regards the transaction as a cash sale. He adds to the cash price interest, at a rate considerably higher than what would be obtained by the investment

of money in sound securities, in order to cover possible losses by default, and he divides this composite price by the agreed number of instalments. He then treats the sale as a sale for deferred payments by equal instalments. Provided that his loading for risk—the excess interest added to the cash price—is sufficient, there is little danger in this method. In order to reduce the volume of book-keeping entries in this sort of transaction certain methods have been adopted, and, accordingly, three typical sets of circumstances are dealt with below, and the system applicable to each is described.

The details of the various agreements met with in practice will, of course, vary considerably. For example, it is usual for the first instalment to be paid on signing the agreement. This practice reduces the unpaid balance of the cash-down price on which interest is calculated. Again, the instalments may be determined by dividing the cash-down price by the agreed number of instalments, and adding to each interest on the outstanding balance. If that is done, the instalments will not be equal, but will gradually decrease. Such inducements to purchase as "free insurance," "service after purchase," or an option to terminate the agreement at will and return a portion of the goods, etc., will need consideration in deciding the precise form of treatment to adopt in a particular case. Still the general principles will remain the same.

(i) *Where goods sold on hire-purchase are of considerable value, and the number of transactions is small, e.g. Railway Wagons or Motor Lorries.*

Here the transaction is dealt with as a cash sale, the balance of the hire-purchase price being treated as interest and credited proportionately to the periods mentioned in the agreement. Thus the whole of the gross profit on the sale is credited to the Trading Account for the period when the sale was effected. This method assumes that the transaction is an ordinary sale with payment by instalments at interest; and in so far as losses are probable through default, reserves must be created to arrive at the actual gross profit. The balance of the personal account of the purchaser will appear on the asset side of the Balance Sheet as "Goods out on Hire-Purchase," any reserve being deducted therefrom. (*See* Illustration 1.)

(ii) *Where goods sold on high-purchase are of small value, the sales considerable, and the periods of the agreements vary, e.g. in the Furnishing trade.*

Only memorandum records are kept of the personal aspect of the transactions. The goods are treated as stock and valued at each balancing date at a proportion of the cost of the goods equivalent to the proportion of the total instalments remaining unpaid. In other words, each instalment is considered as being composed of similar fractions of (*a*) cost, and (*b*) gross profit and interest. A Hire-Purchase Sales Day Book is ruled with suitable columns for infor-

mation as to (1) number of instalments; (2) interval between each instalment, e.g. week, month, or quarter; (3) total of instalments (the hire-purchase price); and (4) cost price. The equivalent cash selling price is ignored. A memorandum Hire Purchasers' Ledger is opened, each account being headed with full details as recorded in the day book. The memorandum personal account is debited with the full hire-purchase price, and credited periodically from the Cash Book with the instalments paid. These detail entries are memoranda only. The double-entry is put through in periodical totals. The total of the cost-price column of the Hire-Purchase Sales Day Book is debited to "Stock out on Hire-Purchase Account," and credited to Hire-Purchase Sales Account, and thence to the Trading Account. The total cash received on account of instalments is periodically posted to the credit of "Stock out on Hire-Purchase Account." At balancing dates, this stock is valued by going through the Hire-Purchasers' Ledger and valuing each account according to the following formula:—

$$\frac{\textit{Number of instalments still due} \times \textit{Cost price}}{\textit{Total number of instalments payable}}$$

The total stock is then inserted on the credit side of the Stock out on Hire-Purchase Account, and carried down as a debit balance to the next period. The difference on this account then shows the profit or loss to be transferred to the Trading Account of the business in the ordinary way. (*See* Illustration 2.)

(iii) *Where goods are sold on hire-purchase, the period being fixed and the transactions considerable, e.g. a billiard-table manufacturer selling tables on monthly instalments over three years.*

The cash price method explained in (i) is adopted with this variation, that the interest instead of being apportioned on the facts of each agreement is treated in total, this being possible owing to the period of each agreement being fixed. Thus, assume that all goods are sold on three-year agreements, the instalments being payable quarterly. Then, if the loading for interest and risk is 8 %, the interest applicable to each of the three years is:—1st year, 52·63 %; 2nd year, 33·83 %; 3rd year, 13·54 % of the total interest.* Most agreements will extend over four years, since they are not all entered into on the

* NOTE.—The proportions of the total interest (i.e. the difference between the hire-purchase price and the cash sale price) applicable to each year will vary with the rate per cent., the interval between the payments, and the total period of the agreement. But as all agreements are standardised, whatever the amount of the instalment may be, the interest included in any one instalment will always bear the same ratio to the interest included in any other instalment. Thus, if a typical example is taken, say a quarterly payment of £10 for three years, the "present worth" = the cash sale price is £105 15s. The total hire-purchase price is £120, and thus the total interest is £14 5s.

[*Note continued on next page.*

first day of the business year. The interest is then approximated by taking credit only for one-half of the first year's interest in that year, then, in the second year, the other half of the first year's interest plus half of the second year's interest, and so on. The interest would be apportioned in the above example, as follows :—

First year	.. ..	26·3 %
Second year	.. .. .. (26·3 + 16·9) =	43·2 %
Third year	.. .. (16·9 + 6·8) =	23·7 %
Fourth year	.. ..	6·8 %
		100·0 %

The Hire-Purchase Day Book is ruled to provide details of the various agreements and, in addition, three money columns for (*a*) Cash Price, (*b*) Interest, (*c*) Total. Column (*c*) is debited to the individual personal accounts in the Hire-Purchasers' Ledger, and these accounts are credited with the cash instalments as paid. Periodically, the totals of the Hire-Purchase Day Book are posted (*a*) to the credit of Hire-Purchase Sales Account (and thence to the Trading Account); (*b*) to the credit of a Hire-Purchase Interest Suspense Account for the period; and (*c*) the total, to the debit of a Hire-Purchasers' Ledger Total Account. The latter account is credited periodically from the Cash Book with the total instalments received, and is operated in the same manner as a Total Debtors' Account. Each year the due percentage of each of the interest suspense accounts is credited to Profit and Loss Account. There will, at any time, be several suspense

Continuation of note from previous page.]

It will be found that £7 10s. of this, or 52·63 % of the total interest, is applicable to the first year, thus :—

Balance at Beginning of Quarter.	Interest thereon at 8 % p.a.	Total.	Quarterly Instalment.	Balance.
£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
105 15 0	2 2 3	107 17 3	10 0 0	97 17 3
97 17 3	1 19 2	99 16 5	10 0 0	89 16 5
89 16 5	1 15 11	91 12 4	10 0 0	81 12 4
81 12 4	1 12 8	83 5 0	10 0 0	73 5 0
	£7 10 0			

The second year's interest will be found to be £4 16s. 5d., or 33·83 %, and the third year's interest £1 18s. 7d., or 13·54 %. This calculation will, of course, only have to be made once, i.e. when the exact terms of the standard agreement are decided upon. A fresh calculation would only be necessary if the rate per cent., or the frequency, or the number of the instalments is varied.

accounts open; for example, if the agreements are for three years, there will be three suspense accounts open, and each Profit and Loss Account will receive benefit from four different suspense accounts. In the Balance Sheet, the total credit balances on the interest suspense accounts are deducted from the debit balance on the Hire-Purchasers' Ledger Total Account, and the net figure shown as "Stock in Hands of Customers on Hire-Purchase Agreements." (*See* Illustration 3.)

Illustration 1.—The Sunlight Motor Company during the year 1932 sells the following on hire-purchase:—

(*a*) To the A. B. Carriage Company, one Lorry, cash selling price £500, payable by five yearly instalments of £115 9s. 9d. (Interest taken at 5 %). Date of agreement, January 1, 1932

(*b*) To the H. F. Meat Company, two Lorries, cash selling price £995 8s., payable by twelve half-yearly instalments of £100 (Interest taken at 6 % with half-yearly rests). Date of agreement, June 1, 1932.

Show the personal accounts of the purchasers in the books of the Sunlight Motor Company up to December 31, 1933, and the entry in the Balance Sheet at that date, no loss on either agreement being anticipated.

Sunlight Motor Company.

BALANCE SHEET, DECEMBER 31, 1933.

(ASSETS SIDE.)

Lorries in hands of customers on Hire-Purchase agreements	£1,093 2 3

GENERAL LEDGER.

The A. B. Carriage Company.

Date: January 1, 1932. Sale of 1 Lorry.
Amount: £577 8s. 9d.
Payable by 5 Yearly *Instalments of* £115 9s. 9d.
Commencing: December 31, 1932.
Cash Value: £500.
Interest: At 5 %.

DR. CR.

		£	s.	d.			£	s.	d.
1932. Jan. 1	To Hire-Purchase Sales Account (Cash Selling Price)	500	0	0	1932. Dec. 31	By Cash, 1st instalment.	115	9	9
Dec. 31	,, Interest Account (5 % for 1 year)	25	0	0	,, 31	,, Balance carried down	409	10	3
		£525	0	0			£525	0	0
1933. Jan. 1	To Balance brought down	409	10	3	1933. Dec. 31	By Cash, 2nd instalment.	115	9	9
Dec. 31	,, Interest Account (5 % for 1 year)	20	9	6	,, 31	,, Balance carried down	314	10	0
		£429	19	9			£429	19	9
1934. Jan. 1	To Balance brought down	314	10	0					

HIRE-PURCHASE INTEREST ACCOUNT.

DR. CR.

		£	s.	d.			£	s.	d.
1932.					1932.				
Dec. 31	To Profit and Loss Account	54	17	3	Dec. 31	By A. B. Carriage Co. ..	25	0	0
					,, 31	,, H. F. Meat Co.	29	17	3
		£54	17	3			£54	17	3
1933.					1933.				
Dec. 31	To Profit and Loss Account	73	16	6	June 30	By H. F. Meat Co.	27	15	2
					Dec. 31	,, H. F. Meat Co	25	11	10
					,, 31	,, A. B. Carriage Co. ..	20	9	6
		£73	16	6			£73	16	6

The H. F. Meat Company.

Date : June 1, 1932. Sale of 2 Lorries.
Amount : £1,200.
Payable by 12 Half-yearly *Instalments of* £100.
Commencing : December 31, 1932.
Cash Value : £995 8s.
Interest : At 6 % (half-yearly rests).

DR. CR.

		£	s.	d.			£	s	d.
1932.					1932.				
June 1	To Hire-Purchase Sales (Cash Selling Price) ..	995	8	0	Dec. 31	By Cash, 1st instalment..	100	0	0
Dec. 31	,, Interest Account (6 % for 6 months)	29	17	3	,, 31	,, Balance carried down	925	5	3
	£	1,025	5	3		£	1,025	5	3
1933.					1933.				
Jan. 1	To Balance brought down	925	5	3	June 30	By Cash, 2nd instalment	100	0	0
June 30	,, Interest Account (6 % for 6 months)	27	15	2	,, 30	,, Balance carried down	853	0	5
		£953	0	5			£953	0	5
1933.					1933.				
July 1	To Balance brought down	853	0	5	Dec. 31	By Cash, 3rd instalment..	100	0	0
Dec. 31	,, Interest Account (6 % for 6 months)	25	11	10	,, 31	,, Balance carried down	778	12	3
		£878	12	3			£878	12	3
1934.									
Jan. 1	To Balance brought down	778	12	3					

HIRE-PURCHASE SALES ACCOUNT.

DR. CR.

		£	s.	d			£	s.	d.
1932.					1932.				
Dec. 31	To Trading Account ..	1,495	8	0	Jan. 1	By A. B. Carriage Co. ..	500	0	0
					June 1	,, H. F. Meat Co.	995	8	0
	£	1,495	8	0		£	1,495	8	0

Illustration 2.—The following are the entries in the Hire-Purchase Day Book of the Ford Furnishing Company, who inaugurated a system of "easy payments" on June 20, 1927. Show the personal account of A. Black in the Hire-Purchasers' Memorandum Ledger, and the Stock out on Hire-Purchase Account in the General Ledger on December 31, 1927, assuming all instalments were received as and when due.

HIRE-PURCHASE DAY BOOK.

Date.	Agreement No.	Details.	Total Instalments. £	s.	d.	Folio.	Cost Price. £	s.	d.
1932.			£	s.	d.		£	s.	d.
July 1	1	A. Black, 10, Lime Avenue, S.E. Bedroom Suite, 12 monthly instalments of £2 commencing July 1st	24	0	0	1	14	0	0
Aug. 10	2	K. Wright, Deepdene, Purley. 4 quarterly instalments of £13 commencing Aug. 10th	52	0	0	3	30	0	0
Sept. 15	3	M. Tyron, 14, The Drive, Wanstead. 24 monthly instalments of £3 commencing Sept. 15th	72	0	0	5	48	0	0
Oct. 1	4	B. Fore, Rahere, Dorking. 6 monthly instalments of £10 commencing Oct. 1st	60	0	0	7	40	0	0
Nov. 30	5	W. Seed, 91, High Street, W. 8 quarterly instalments of £15 commencing Nov. 30th	120	0	0	9	72	0	0
Dec. 7	6	B. Smith, 14, Sunray Avenue, N. 52 weekly instalments of £1 10s. commencing Dec. 7th	78	0	0	11	50	0	0
			£406	0	0		£254	0	0

HIRE-PURCHASERS' MEMORANDUM LEDGER.

Name of Hire-Purchaser : A. Black.
Address : 10, Lime Avenue, S.E.
Agreement Number : 1.
Date : July 1, 1932.
Articles : Bedroom Suite.
Cost Price : £14.
Instalments : 12, monthly, £2 each July 1st and thereafter.
Total Instalments : £24.

Dr. Cr.

Date		D.B.	£	s.	d.	Date		C.B.	£	s.	d.
1932.						1932.					
July 1	To Total Instalments	1	24	0	0	July 1	By Cash	15	2	0	0
						Aug. 1	„ Cash	17	2	0	0
						Sept. 1	„ Cash	19	2	0	0
						Oct. 1	„ Cash	22	2	0	0
						Nov. 1	„ Cash	24	2	0	0
						Dec. 1	„ Cash	27	2	0	0
						„ 31	„ Balance carried down	√	12	0	0
			£24	0	0				£24	0	0
1933.											
Jan. 1	To Balance brought down	√	12	0	0						

GENERAL LEDGER.

Stock out on Hire-Purchase.

Dr.		£	s.	d.		Cr.	£	s.	d.
1932. Dec. 31	To Cost of Stock sent out under Hire-Purchase Agreements during the year (as per Hire-Purchase Sales Day Book)	254	0	0	1932. Dec. 31	By Cash (Instalments received from Hire-Purchasers during the year)	101	0	0
„ 31	„ Profit and Loss Account (profit on hire-purchase business for the year)..	38	3	1	„ 31	„ Value of Stock out on hire-purchase at end of year (see schedule) ..	191	3	1
		£292	3	1			£292	3	1
1933. Jan. 1	To Value of stock out on hire-purchase at this date	191	3	1					

Hire-Purchase Sales.

Dr.		£	s.	d.		Cr.	£	s.	d.
1932. Dec. 31	To Trading Account ..	254	0	0	1932. Dec. 31	By Stock out on Hire-Purchase Account ..	254	0	0

VALUATION OF HIRE-PURCHASE STOCK AT DECEMBER 31, 1932.

Hire-Purchase Ledger Folio.	Total Number of Instalments.	Number Paid.	Number Unpaid.	Cost. £	s.	d.	Proportion of Cost.	Value of Stock. £	s.	d.
1	12	6	6	14	0	0	6/12	7	0	0
2	4	2	2	30	0	0	2/4	15	0	0
3	24	4	20	48	0	0	20/24	40	0	0
4	6	3	3	40	0	0	3/6	20	0	0
5	8	1	7	72	0	0	7/8	63	0	0
6	52	4	48	50	0	0	48/52	46	3	1
	106	20	86					£191	3	1

If goods are returned and the agreement is cancelled, the cost price unpaid must be credited to Stock out on Hire-Purchase Account, and debited to Hire-Purchase Returns Account, the goods being taken into general stock at a valuation, and any balance being written off. For example, if A. Black makes no further payments and the goods are seized, Stock out on Hire-Purchase Account will be credited with £7 and Hire-Purchase Returns Account debited. If the goods returned are worth only £4, Trading Account will be debited with £4; Profit and Loss Account be debited with the loss of £3; and Hire-Purchase Returns Account be credited with £7.

Illustration 3.—The Fibre Gramophone Company manufactures a number of instruments ranging in price from £3 to 100 guineas. These are sold for cash or on the hire-purchase system. The hire-purchase price is based on the cash selling price, to which interest is added at 8 % per

HIRE-PURCHASE INTEREST SUSPENSE ACCOUNT, 1931.

Total, £1,068 15s. Chargeable: 1931, 26·3 %, £281 1s. 7d.; 1932, 43·2 %, £461 14s.; 1933, 23·7 %, £253 5s. 11d.; 1934, 6·8 %, £72 13s. 6d.

DR. CR.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Profit and Loss Account	461	14	0	1932. Jan 1	By Balance brought forward	787	13	5
" 31	" Balance carried down..	325	19	5					
		£787	13	5			£787	13	5
					1933. Jan 1	By Balance brought down	325	19	5

HIRE-PURCHASE INTEREST SUSPENSE ACCOUNT, 1932.

Total, £1,425. Chargeable: 1932, 26·3 %, £374 15s. 6d.; 1933, 43·2 %, £615 12s.; 1934, 23·7 %, £337 14s. 6d.; 1935, 6·8 %, £96 18s.

DR. CR.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Profit and Loss Account..	374	15	6	1932. Dec. 31	By Hire-Purchasers' Ledger Total Account	1,425	0	0
" 31	" Balance carried down	1,050	4	6					
		£1,425	0	0			£1,425	0	0
					1933. Jan. 1	By Balance brought down	1,050	4	6

HIRE-PURCHASE SALES ACCOUNT.

DR. CR.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Trading Account ..	10,575	0	0	1932. Dec. 31	By Hire-Purchasers' Ledger Total Account	10,575	0	0

HIRE-PURCHASERS' LEDGER TOTAL ACCOUNT.

DR. CR.

		£	s.	d.			£	s.	d.
1932. Jan. 1	To Balance brought forward	10,700	0	0	1932. Dec. 31	By Cash instalments received	7,200	0	0
Dec. 31	" Hire-Purchase Sales for year	12,000	0	0	" 31	" Balance carried down	15,500	0	0
	£	22,700	0	0		£	22,700	0	0
1933. Jan. 1	To Balance brought down	15,500	0	0					

PROFIT AND LOSS ACCOUNT, 1932.

DR. CR

		£	s.	d.			£	s.	d.
					1932. Dec. 31	By Hire-Purchase Interest, 1929	9	13	10
					" 31	" Hire-Purchase Interest, 1930	168	17	3
					" 31	" Hire-Purchase Interest, 1931	461	14	0
					" 31	" Hire-Purchase Interest, 1932	374	15	6
							£1,015	0	7

The Fibre Gramophone Company.

BALANCE SHEET, DECEMBER 31, 1932.

(ASSETS SIDE.)

	£	s.	d.
Stock in hands of customers on Hire-Purchase Agreements	14,075	7	1

NOTE.—This figure is arrived at as follows :—

	£	s.	d.	£	s.	d.
Hire-Purchasers' Ledger Total Account (Debit balance)				15,500	0	0
Less Credit balances on Hire-Purchase Interest Suspense Accounts :—						
1930	48	9	0			
1931	325	19	5			
1932	1,050	4	6			
				1,424	12	11
				£14,075	7	1

Sales for Deferred Payments by Instalments.

(A) *The Seller's Books.*—The entries in the books of the seller may be similar to those discussed in relation to Hire-Purchase. Two important points of difference arise, however :—

(1) Since there is no legal right to reclaim the goods, it is essential to provide an adequate reserve for bad debts.

(2) The amount due from the purchaser may be described in the Balance Sheet as Debtors instead of Stock.

(B) *The Buyer's Books.*—The complication found in the seller's books is not repeated in those of the buyer, as the transactions are generally few in number. Again, the cost of the asset, if purchased for cash, is undoubtedly a capital charge in the first place, although, of course, wastage must be charged against revenue as and when depreciation occurs. It is usual, therefore, to adopt the cash-price method, either : (i) dealing with each instalment, as and when due, by debiting revenue with so much of that instalment as represents interest or hire, and debiting the balance to capital ; or (ii) raising an asset account by debiting thereto the cash purchase price of the asset, and crediting the vendor.

Periodically the vendor is credited with interest on the balance outstanding, and debited with the cash instalment.

In either case the asset must be depreciated on the basis of a full cash purchase price.

If the second method is adopted, the credit balance on the vendor's account is deducted from the debit balance on the asset account, and shown in the Balance Sheet as "Assets in Course of Hire-Purchase, less Depreciation."

The second method is recommended, and has been officially approved by the Inland Revenue in the case of the hire-purchase of railway wagons, the difference between the cash value and the total instalments payable being treated as hire and allowed in equal annual amounts spread over the term of the agreement, wear and tear being allowed on the cash value. (*See* Illustrations 4 and 5.)

Purchases for Deferred Payments by Instalments.—The entries in the books of the buyer may be similar to those detailed above in relation to hire-purchases, the second method being usually adopted. In the Balance Sheet, the credit balance on the vendor's account appears on the liabilities side, and the debit balance on the asset account (less depreciation) on the assets side.

Illustration 4.—The A. B. Carriage Company purchased on January 1, 1932, from the Sunlight Motor Company one lorry on a hire-purchase agreement providing for the payment of five yearly instalments of £115 9s. 9d. each. The Sunlight Motor Company charges interest at 5 %. Reference to an annuity table gives the present value of an annuity of £1 for five years at 5 % as 4·329477. Depreciation is to be written off at 10 % per annum. Show the accounts in the books of the Carriage Company.

(The cash value of the motor is 115·398 × 4·329477 = £500.)

The A. B. Carriage Company.

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
1932. Dec. 31	Motor Lorry (Hire-Purchase Account) .. .. .. Dr.	90	9	9			
	Hire Account (5 % on £500) .. .. Dr.	25	0	0			
	To Sunlight Motor Co.				115	9	9
	Being first instalment payable under Hire-Purchase agreement dated January 1, 1932, providing for 5 yearly instalments of £115 9s. 9d. commencing December 31, 1932. Cash price £500; interest taken at 5 %.						
1933. Dec. 31	Motor Lorry .. .. Dr.	95	0	3			
	Hire Account (5 % on £409 10s. 3d.) .. .. .. Dr.	20	9	6			
	To Sunlight Motor Co.				115	9	9
1934. Dec. 31	Motor Lorry .. .. Dr.	99	15	3			
	Hire Account (5 % on £314 10s. 0d.) .. .. .. Dr.	15	14	6			
	To Sunlight Motor Co				115	9	9
1935. Dec. 31	Motor Lorry .. .. Dr.	104	15	0			
	Hire Account (5 % on £214 14s. 9d.) .. .. .. Dr.	10	14	9			
	To Sunlight Motor Co.				115	9	9
1936 Dec. 31	Motor Lorry .. .. Dr.	109	19	9			
	Hire Account (5 % on £109 19s. 9d.) .. .. .. Dr.	5	10	0			
	To Sunlight Motor Co.				115	9	9

MOTOR LORRY. HIRE-PURCHASE ACCOUNT.

Dr.		£	s.	d.	Cr.		£	s.	d.
1932. Dec. 31	To Motor Co.	90	9	9	1936. Dec. 31	By Transfer from Depreciation Account	204	15	1
1933. Dec. 31	,, Motor Co.	95	0	3	,, 31	,, Balance carried down ..	295	4	11
1934. Dec. 31	,, Motor Co.	99	15	3					
1935. Dec. 31	,, Motor Co.	104	15	0					
1936. Dec. 31	,, Motor Co.	109	19	9					
		£500	0	0			£500	0	0
1937. Jan. 1	To Balance brought down	295	4	11					

MOTOR LORRY. DEPRECIATION ACCOUNT.

Dr.		£	s.	d.	Cr.		£	s.	d.
1936. Dec. 31	To Transfer to Motor Lorry Account	204	15	1	1932. Dec. 31	By Profit and Loss Account (10 % on £500)	50	0	0
					1933. Dec. 31	,, Profit and Loss Account (10 % on £450)	45	0	0
					1934. Dec. 31	,, Profit and Loss Account (10 % on £405)	40	10	0
					1935. Dec. 31	,, Profit and Loss Account (10 % on £364 10s. 0d.)	36	9	0
					1936. Dec. 31	,, Profit and Loss Account (10 % on £328 1s. 0d.) ..	32	16	1
		£204	15	1			£204	15	1

SUNLIGHT MOTOR COMPANY (HIRE-PURCHASE ACCOUNT).

Dr.		£	s.	d.	Cr.		£	s.	d.
1931. Dec. 31	To Cash	115	9	9	1932. Dec. 31	By Sundries	115	9	9

(And so on for five years.)

The Hire Account is closed by transfer to Profit and Loss Account each year. The Depreciation Account has been shown separately for the sake of clarity, while the debit on Motor Lorry Account is increasing each year; in future, depreciation may be credited to the Asset Account in the usual way.

Illustration 5.—The H. F. Meat Company purchases two Motor Lorries from the Sunlight Motor Company on a hire-purchase agreement dated July 1, 1932, providing for twelve half-yearly instalments of £100, commencing December 31, 1932. The cash purchase price of the lorries is £995 8s., interest being computed at 6 %, with half-yearly rests.

Show the accounts of the H. F. Meat Company up to December 31, 1933, and the entries in the Balance Sheet as at that date. Write off depreciation at 10 % per annum.

The H. F. Meat Company.

BALANCE SHEET, DECEMBER 31, 1933.

ASSETS.

	£	s.	d.	£	s.	d.
Motor Lorries on Hire-Purchase at cash value ..	995	8	0			
Less Depreciation	144	6	8			
	£851	1	4			
Less Balance of Purchase price unpaid	778	12	3			
				72	9	1

The H. F. Meat Company.

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
1932. July 1	Motor Lorries (Hire-Purchase Account) .. .. Dr.	995	8	0			
	To Sunlight Motor Co.				995	8	0
	Being present worth of 12 half-yearly instalments of £100 commencing December 31, 1932, payable under agreement dated July 1, 1932. Interest at 6 % with half-yearly rests.						

SUNLIGHT MOTOR COMPANY (HIRE-PURCHASE ACCOUNT).

Dr.		£	s.	d.		Cr.	£	s.	d.
1932. Dec. 31	To Cash	100	0	0	1932. July 1	By Motor Lorries Account	995	8	0
„ 31	„ Balance carried down	925	5	3	Dec. 31	„ Interest Account (6 % for 6 months)	29	17	3
	£	1,025	5	3		£	1,025	5	3
1933. June 30	To Cash	100	0	0	1933. Jan. 1	By Balance brought down	925	5	3
„ 30	„ Balance carried down	853	0	5	June 30	„ Interest Account (6 % for 6 months)	27	15	2
		£953	0	5			£953	0	5
1933. Dec. 31	To Cash	100	0	0	1933. July 1	By Balance brought down	853	0	5
„ 31	„ Balance carried down	778	12	3	Dec. 31	„ Interest Account (6 % for 6 months)	25	11	10
		£878	12	3			£878	12	3
					1934. Jan. 1	By Balance brought down	778	12	3

MOTOR LORRIES (HIRE-PURCHASE ACCOUNT).

Dr.		£	s.	d.		Cr.	£	s.	d.
1932. July 1	To Sunlight Motor Co. ..	995	8	0	1932 Dec. 31	By Depreciation (10 % on £995 8s. 0d. for 6 mos.)	49	15	5
					" 31	" Balance carried down	945	12	7
		£995	8	0			£995	8	0
1933. Jan. 1	To Balance brought down	945	12	7	1933. Dec. 31	By Depreciation (10 % on £945 12s. 7d.)	94	11	3
					" 31	" Balance carried down	851	1	4
		£945	12	7			£945	12	7
1934. Jan. 1	To Balance brought down	851	1	4					

EXAMINATION QUESTIONS.

1. Differentiate between Hire-Purchase and Instalment Payment. (*Central Association Accountants.*)

2. The Three Speed Motor Company, Ltd., sold a car (No. 3786) to Hugh Dickson on Hire-Purchase terms as follows: Total purchase price of car, £600, payable in ten quarterly (usual quarter-days) instalments of £60 each. The cost price of the car to the Company was £430.

State how the Company should record this transaction in their books, and illustrate your answer by *two only* of the Ledger Accounts you describe. (*Royal Society Arts.*)

3. What are the main features of Hire-Purchase agreements, and how would you show in the accounts the total amounts due under such agreements, and the various instalments payable from time to time thereunder? (*Incorporated Accountants.*)

4. Explain what you understand by a Hire-Purchase agreement. Show how the books of a furniture dealer, selling goods on the Hire-Purchase system, should be kept, and insert a few typical entries in the various books which you name.

Show on what principles the Trading Account and Balance Sheet of a business of this kind should be constructed. (*Incorporated Accountants.*)

5. A colliery company hires 100 wagons on the deferred-purchase system over a term of seven years, the rent being payable by quarterly instalments of £200, with an addition for repairs of £2 per wagon per annum. Assuming the wagon company's charge for interest on the cash price of the wagons to be 5 % per annum, make the Journal entries for the first year necessary to apportion the quarterly payments between Capital and Revenue. (*Chartered Accountants.*)

6. A colliery company purchased on December 31, 19.., railway wagons for £1,000, payable £100 down and the balance spread over three years by equal annual instalments plus 5 % interest on the balance outstanding. Depreciation at 10 % is written off by the colliery company. Show the entries required in the books of the colliery company balancing the accounts annually. (*Institute of Book-keepers.*)

7. On March 1st the B. S. Coal Company obtained wagons on the Hire-Purchase system. The price of the wagons was £1,150. Payment was to

be made, as to £150 down and as to the balance at £200 per year with 5 % interest.

The B. S. Coal Company write off 10 % depreciation each year.

Construct the necessary Ledger accounts in the books of the company, showing in detail the entries. (*Incorporated Accountants.*)

8. The Hard Coal Colliery Company, Ltd., agreed to purchase from the International Wagon Company, Ltd., 100 railway wagons, at the price of £50 per wagon, paying for the same by half-yearly instalments of £300 such instalments to include interest on the unpaid purchase money at the rate of 7% per annum.

The date of the purchase was January 1st, and the first half-yearly instalment was due July 1st.

Write up the Hard Coal Colliery Company's Account in the Wagon Company's books for three years, and also write up the Wagon Account in the Colliery Company's books for the same period. (*Chartered Accountants.*)

Chapter XVII

ROYALTY ACCOUNTS

Definition.—Royalty is a money payment, in the nature of rent, made for the right to use, produce, or reproduce certain classes of property, e.g. patents, copyrights, mineral rights, etc., the legal ownership of which is vested in another. Thus, the owner of a patent is the patentee; the owner of the copyright in a play, book, musical composition, or work of art is the author or the artist; the owner of ungotten minerals is the owner of the land on or beneath which the minerals lie. A patentee, copyright owner, land-owner, etc., may sell his proprietary rights outright; or exploit them himself; or concede the rights of exploitation to others. If he concedes the rights, the consideration usually takes the form of a *royalty*, i.e. of the payment of a definite sum of money for each article sold made according to the patent; or for each copy of the play, book, musical composition, or other work of art reproduced and sold; or for each ton, or other measure, of minerals won. From the owner's point of view, royalties are income, after making provision for any capital expenditure incurred that may die with the patent, copyright, or other royalty-producing property. From the concessionaire's point of view, money paid as royalty forms part of the manufacturing or producing expenses of the business, and should be charged to Manufacturing Account. Neither of these aspects offer any unusual book-keeping features, and need not be dealt with further.

Coal-mining Royalties.—Owing to trade customs, these royalties entail special book-keeping records, and need particular mention. The ordinary book-keeping records of a colliery follow the usual lines. The coal won is weighed at the pit-head, and checked by the *check-weigher* (the miners' representative). These weights are recorded in the Output Book, and, as the coal is sold, either in the Sales Book, or, where the sales are made under contract, in the Sales Contract Book. Both these books contain columns to record the output from different seams, or, if more than one pit is worked, from the different seams of each pit. To facilitate costing, wages are suitably analysed as between pit and surface workers. The Purchases Book is ruled to accommodate close analysis of materials purchased, e.g. pit-prop timber, weigh-bridges, lamps, oil, wagons, crutches, tools, railway dues, etc.

Development Expenditure.—In the case of a new collery, the cost

of development, i.e. of sinking shafts, cutting main roads, installing pumping and ventilating machinery, and erecting surface buildings with their machinery, is capitalised. When the production stage has been reached the method to be adopted for writing off the expenditure over a term of years must be carefully considered. This is sometimes done by creating a Sinking Fund based upon output. In many cases the question of providing out of revenue for capital sunk in development is ignored. In such event all dividends received must be regarded as including a modicum of capital.

Mining Royalties.—These are calculated in various ways. Usually, they are based upon an agreed rate per ton, e.g. 6d. per ton. But sometimes the royalty varies for different seams; a greater royalty being paid on coal won from a thick seam that may be easy to work, than from a thin seam that may be difficult to work. When paying royalty, the lessee should deduct income tax at the current rate.

Minimum (Dead, or Fixed) Rent.—In order to ensure that the mineral value shall be adequately exploited, the majority of mining leases guarantee the lessor a fixed minimum rent, irrespective of the tonnage of coal won. This minimum, dead, or fixed rent merges into a royalty when the tonnage won is sufficiently large to cover the minimum, but it must be paid to the lessor whatever the tonnage won.

Surface Compensation.—Mining leases frequently provide for payment of compensation to the owner of the land should damage be caused to the surface by subsidence, dumping of refuse, or other cause. If such claims are likely to materialise, provision must be made to meet them. Reserves made for the purpose are usually based upon output.

Wayleaves.—These are charges or rents paid for the right to transport coal under or over land belonging to neighbouring landowners. The charge or rent is generally fixed upon the basis of the tonnage of coal transported.

Short-Workings (Shorts).—In the case of new collieries, the royalties during the first few years of mine development rarely reach the amount fixed as the minimum rent. The amount by which the royalty falls short of this rent is termed *short-workings*. Most mining leases include an "average clause," which gives the lessee the right for a limited period (three to seven years) to recover these short-workings out of royalties as soon as the royalties payable exceed in amount the minimum rent. Briefly put, the lessor receives either the minimum rent or the agreed royalties, whichever is the greater. The royalty account is charged with royalty on the coal actually won, and the amount of the short-workings is carried forward as expenditure paid in advance throughout the period during which such short-workings are recoverable. Justification for this treatment depends upon the terms of the lease, and the probability of winning a tonnage output the royalties on which will, within the time allowed for recoupment, exceed the

minimum rent. Should the royalties on the tonnage won within the period allowed for the recoupment of short-workings prove less than the minimum rent payable over that period, the balance of short-workings must be written off as irrecoverable.

The entries during the periods in which the right to recoup short-workings exists may be summarised as follows :—

(*a*) *When the Royalty is less than the agreed minimum rent.*
Debit Royalty Account with the actual royalty earned ;
Debit Short-workings Account with the deficiency ;
Credit Lessor with the amount of the minimum rent.

The Royalty Account is closed by transfer to the Profit and Loss Account ; the Lessor's Account is closed by payment of cash. The debit balance on Short-workings Account may be carried forward as a temporary asset if (1) the right to recoup these short-workings exists in the following year or years, and (2) if it is probable that the output in future will be large enough to enable the short-workings to be recouped.

(*b*) *When the Royalty exceeds the minimum rent.*
(1) If there is a debit balance on Short-workings Account,
Debit Royalty Account with the actual royalty earned ;
Credit the landlord with the minimum rent ;
Credit Short-workings Account with the excess.
(2) Where there are no short-workings to be recovered,
Debit Royalty Account with the actual royalty payable, and
Credit the landlord with the same amount.

It will be seen that, in any case, the Royalty Account is debited with the actual royalty payable on the coal " gotten," and closed by transfer to the Profit and Loss Account. Any amount brought forward from previous years on Short-workings Account, which is found to be irrecoverable, must be written-off to Profit and Loss Account as short-workings, and any amount by which the minimum rent exceeds the royalty in any year must, if no right exists to recoup it, be debited to that year's Profit and Loss Account as short-workings.

The following illustration should make the treatment clear.

Illustration.—The lease of a colliery is granted upon the basis of a royalty of 6d. per ton on the coal won, subject to a minimum rent of £1,000 per annum ; the tenant has the right to recoup short-workings during the first seven years of the lease, but not afterwards. The output in tons was as follows :—1932, first year, 20,000 ; 1933, second year, 30,000 ; 1934, third year, 40,000 ; 1935, fourth year, 48,000 ; 1936, fifth year, 35,000 ; 1937, sixth year, 44,000 ; 1938, seventh year, 36,400 ; 1939, eighth year, 60,000. Ignore income tax.

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		£	s.	d.	£	s.	d.
1932. Dec 31	Royalty Account .. .. Dr.	500	0	0			
	Short-workings Account .. .. Dr.	500	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6d. per ton on 20,000 tons raised and agreed minimum rent of £1,000.						
1933. Dec. 31	Royalty Account .. .. Dr.	750	0	0			
	Short-workings Account .. .. Dr.	250	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6d. per ton on 30,000 tons raised and agreed minimum rent of £1,000.						
1934. Dec. 31	Royalty Account .. .. Dr.	1,000	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6d. per ton on 40,000 tons raised.						
1935. Dec. 31	Royalty Account .. .. Dr.	1,200	0	0			
	To Landlord				1,000	0	0
	,, Short-workings Account				200	0	0
	Being royalty of 6d. per ton on 48,000 tons raised. Minimum rent of £1,000, and short-workings recovered £200.						
1936. Dec. 31	Royalty Account .. .. Dr.	875	0	0			
	Short-workings Account .. .. Dr.	125	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6d. per ton on 35,000 tons raised and agreed minimum rent of £1,000.						
1937. Dec. 31	Royalty Account .. .. Dr.	1,100	0	0			
	To Landlord				1,000	0	0
	,, Short-workings Account				100	0	0
	Being royalty of 6d. per ton on 44,000 tons raised. Minimum rent of £1,000, and short-workings recovered £100.						
1938. Dec. 31	Royalty Account .. .. Dr.	910	0	0			
	Short-workings Account .. .. Dr.	90	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6d. per ton on 36,400 tons raised and agreed minimum rent of £1,000.						
,, 31	Profit and Loss Account .. .. Dr.	665	0	0			
	To Short-workings Account				665	0	0
	Being short-workings written off as irrecoverable.						
1939. Dec. 31	Royalty Account .. .. Dr.	1,500	0	0			
	To Landlord				1,500	0	0
	Being royalty of 6d. per ton on 60,000 tons raised.						

The Royalty Account is closed each year by transfer to the Profit and Loss Account. The Landlord's Account is closed by the payment of cash. The balance on Short-workings Account is carried forward each year till 1938, when, the right of recoupment having ceased, the balance must be written off.

Dr. SHORT-WORKINGS ACCOUNT. Cr

		£	s.	d.			£	s.	d.
1932. Dec 31	To Landlord	500	0	0	1933. Dec. 31	By Balance carried down	750	0	0
1933. Dec. 31	,, Landlord	250	0	0					
		£750	0	0			£750	0	0
1934. Jan. 1	To Balance brought down	750	0	0	1935. Dec. 31	By Landlord	200	0	0
						,, Balance c/d	550	0	0
		£750	0	0			£750	0	0
1936. Jan. 1	To Balance b/d ..	550	0	0	1937. Dec. 31	By Landlord	100	0	0
Dec. 31	,, Landlord	125	0	0		,, Balance c/d	575	0	0
		£675	0	0			£675	0	0
1938. Dec. 31	To Balance b/d ..	575	0	0	1938. Dec. 31	By Profit and Loss Account	665	0	0
	,, Landlord	90	0	0					
		£665	0	0			£665	0	0

EXAMINATION QUESTIONS.

1. Explain the term "Royalties" as employed in connection with coal-mining, and describe the various bases upon which royalties are commonly calculated. (*Royal Society Arts.*)

2. Explain briefly, by means of *pro-forma* examples, how "royalties" and "short-workings," arising out of a mining lease, are dealt with in the books of the lessee of a colliery. (*Royal Society Arts.*)

3. The Coaley Colliery Company, Ltd., pay a royalty to a ground landlord of 9d. per ton of coal raised, with a minimum of £1,200 per annum, with power to recoup short-workings. In the first year they raised 20,000 tons; in the second year, 30,000 tons; in the third year, 44,000 tons. How would you deal with these items year by year in the Profit and Loss Accounts and Balance Sheets of the Company? (*Lancashire and Cheshire Institutes.*)

4. The Coal Mine Company, Ltd., took a lease of a colliery from G. Risch for 99 years from September 29th, at a ground rent of £50 a year, payable half-yearly, and a royalty of 6d. per ton, with a minimum royalty of £80 a year, payable half-yearly. During the first year the Company raised 2,500 tons, and during the second year ended September 29th, 4,000 tons. The several amounts to G. Risch were paid twenty-one days after becoming due. Write up both Personal and Nominal Accounts, and balance them at the end of each year. (*Chartered Accountants.*)

5. A and B, colliery proprietors, take a 21 years' lease at a dead rent of £600 per annum, merging into a royalty of 1s. a ton. The dead rents are recoverable out of royalties paid within five years. 800 tons were raised the first year, 4,600 the second year, and 75,000 the third year. 100 colliery wagons were purchased on the hire-purchase system, by which the wagons, at the end of ten years, became their absolute property in consideration of 15s. a month for each wagon. It was assumed by the firm that each wagon would be worth £40 at the end of the ten years. Show the Ledger accounts for Dead Rents, Royalties, Purchase of Wagons for the first three years. (*Chartered Accountants.*)

6. The United Coal Company, Ltd., are granted a lease of 21 years at a minimum rent of £4,000 per annum merging into a royalty rent of 6d. per ton of coal raised. During the first year the output was 90,000 tons; during the second year the output was 160,000 tons; and during the third year the output was 250,000 tons. Make the necessary Journal Entries and write up the Personal and Nominal Ledger Accounts affected. (*Incorporated Accountants.*)

Chapter XVIII

INSOLVENCY

[Note.—The abbreviation R.O. used in this chapter = Receiving Order; O.R. = Official Receiver; C. of I. = Committee of Inspection; D. of A. = Deed(s) of Arrangement; B.R. = *Bankruptcy Rules*, 1915–1926. The references are to the *Bankruptcy Act*, 1914, unless otherwise stated.]

It is necessary at the outset to distinguish between Insolvency and Bankruptcy. *Insolvency* is the state of a debtor who is unable to pay his debts as they fall due; *Bankruptcy* occurs when the affairs of the insolvent debtor have been brought to the knowledge of the Court, and he has been adjudged bankrupt by the Court, under the Bankruptcy laws. Many insolvent persons never reach the stage of bankruptcy. They compound with their creditors under *Deeds of Arrangement*, as explained below, and so escape the stigma of bankruptcy proceedings. Nevertheless, such persons are frequently, but incorrectly, referred to as bankrupts.

There are degrees of insolvency. An insolvent person, hampered only by a small deficiency of assets, might continue to trade and incur fresh debts; and, if success should attend him, might succeed in regaining his solvency. But, generally speaking, it is not in the interests of the trading community that insolvent persons should continue to add to their liabilities in the, usually, vain hope of recovering their position. Commonly, the insolvent person needs to be protected from himself; his assets must be safeguarded so that his creditors shall receive their *pro rata* share of them; and, when he has satisfied his creditors to his utmost capacity, it is but fair that he should be freed from further liability in respect of his past trading, in order that he may be able to make a fresh start. These are the humane and just objects that the *Bankruptcy Act*, 1914, *The Bankruptcy (Amendment) Act*, 1926, and the *Bankruptcy Rules*, 1915–1926, which now govern all proceedings in bankruptcy, are designed to secure.

Who may be made Bankrupt.—Any adult person who has committed an Act of Bankruptcy within three months of the date of the petition, and whose debt or debts to the petitioning creditor or creditors amount to £50 may be made a bankrupt. It is doubtful if an infant can be made bankrupt, but perhaps he can after he has attained his majority, if the debts were contracted for "necessaries."

Foreigners.—An alien debtor may be made bankrupt if he is subject to English bankruptcy jurisdiction, and has committed an act of bankruptcy here.

Married Women.—Every married woman who carries on a trade or business, whether separately from her husband or not, is subject to the bankruptcy laws as if she were a single woman.

Lunatics.—Persons of unsound mind can apparently be made bankrupt only with consent of the Court in Lunacy, or on an act of bankruptcy committed while sane.

Convicts.—These may be made bankrupt.

Bankruptcy Petition.—Proceedings are begun by the presentation to the Court of a petition * asking for a *Receiving Order.* This may be done either by the debtor or by a creditor or creditors. If the debtor himself petitions, he must allege inability to pay his debts, and the Court will then immediately make the Order. Usually the petition is presented by one or more creditors, whose debt, or combined debts, amount to the sum of £50, and then the petition must show that the debtor has committed an act of bankruptcy within three months of the presentation of the petition. A sealed copy of the petition must be served on the debtor not less than eight days before the day fixed for hearing the petition. The granting of a R.O. does not make the debtor a bankrupt, but it protects his property by placing it under the control of an officer of the Court, termed the *Official Receiver.*

Acts of Bankruptcy.—An act of bankruptcy is an act, or default, of a debtor, deemed by the Court to be evidence of insolvency, any one of which, committed by a debtor, entitles a creditor to present a petition in bankruptcy against the debtor. Briefly stated, they are, by S. 1 (1), as follows :—

(1) If the debtor makes a conveyance or assignment of his property to a trustee or trustees for the benefit of his creditors generally.

(2) If he makes a fraudulent conveyance, gift, delivery, or transfer of his property or of any part thereof.

(3) If, being under no pressure so to do, he, with the intention of giving a creditor, or any surety or guarantor for the debt due to such creditor, a preference over the other creditors, makes any conveyance or transfer of his property or any part thereof, which in law would be void as a fraudulent preference if he were adjudged bankrupt.

(4) If, with intent to defeat or delay his creditors, he does any of the following things :—

* Upon the presentation of a Petition with the Official Receiver, the debtor must deposit £5. If a creditor petitions, he must deposit £7 10s., and such further sum as the Court may direct to cover fees and expenses. (*Bankruptcy Rules*, 1926.)

(a) Departs out of England, or,
(b) Being out of England, remains out of England, or
(c) Departs from his dwelling-house, or otherwise absents himself; or begins to keep house.

(5) If execution against him has been levied by seizure of his goods under process in an action in any Court, or in any civil proceeding in the High Court, and the goods have been either sold or held by the sheriff for twenty-one days.

(6) If he files a declaration of his inability to pay his debts, or presents a bankruptcy petition against himself.

(7) If a creditor entitled to enforce a final judgment for any amount against the debtor serves on him a Bankruptcy Notice, and the debtor does not within seven days comply with the requirements of the notice.

(8) If the debtor gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debts.

Receiving Order.—If the petition is presented by a creditor, it must be verified by affidavit. At the hearing, the Court requires proof of the petitioning creditor's debt, evidence of the service of the petition, and proof of the commission of the act of bankruptcy. If the Court is satisfied on these points, it may make a R.O.

When the R.O. is made, the O.R. becomes the receiver of the debtor's property, and all actions against the debtor's person or property in respect of any debt provable in the bankruptcy are prohibited, except by leave of the Court, and on such terms as the Court may impose. The R.O. must be advertised in the *Gazette*, and in one local paper. The debtor is not yet a bankrupt. Before the Court will make an Adjudication Order declaring the debtor bankrupt, the debtor has to submit to the O.R., in duplicate, a Statement of Affairs as at the date of the R.O., attend the First Meeting of his creditors, and submit to his Public Examination.

Statement of Affairs.—After the R.O. is made, the debtor must make out and submit to the O.R. a Statement of Affairs, in the prescribed form. If the R.O. was made on the debtor's own petition, the statement must be submitted within three days of the date of the R.O., if on a creditor's petition, then within seven days of its date. If necessary, the debtor may obtain professional assistance in preparing this statement. Non-disclosure of any property by the debtor is a misdemeanour.

The official Statement of Affairs in bankruptcy consists of the following forms:—

(1) The "Front Sheet," which is a statement in summary form showing the debtor's estimate of his property and liabilities. The property is not shown at book values, or the values to the business as a going concern as in a Balance Sheet, but at the estimated realisable, or break-up values. The object of this statement

is to estimate the amount available to meet the claims of unsecured creditors after paying off the preferential and secured creditors. Fully secured creditors holding property of the debtor may ignore the bankruptcy and rely on their security to satisfy their claims. Creditors but partly secured rank as unsecured creditors for the balance of their claims. The balance of this Statement will show either a deficiency or a surplus.

(2) Forms giving details of the totals shown in the summary Statement of Affairs: List A, Unsecured Creditors; B, Creditors Fully Secured; C, Creditors Partly Secured; D, Liability of Debtor on Bills Discounted other than his own acceptances for value; E, Contingent or other liabilities; F, Creditors for Rent, etc., recoverable by distress; G, Preferential Creditors for Rates, Taxes, and Wages; H, Property; I, Debts due to the Estate; J, Bills of Exchange, Promissory Notes, etc., available as assets; L, In substitution for such of Sheets A to J as will have to be returned blank.

(3) The Deficiency (or Surplus) Account (List K). This explains how the deficiency (or surplus) shown in the Statement of Affairs arose. It is practically a Capital Account of the Debtor, and starts with the opening Capital (or Deficiency) at a date twelve months before the date of the R.O., or from such other date as the O.R. may fix. The net profit from the business and any other income during the period is also shown. Against this is set-off business losses (including the amounts written off assets brought into the Statement of Affairs below cost or book value), and expenses, other than trade expenses, such as household expenses. The balance of the account shows the deficiency (or surplus) as per the Statement of Affairs.

Preferential Creditors.—Certain unsecured debts are payable in priority to other unsecured debts; and as amongst themselves certain of these preferential debts have a pre-preference.

Preferential Debts with Pre-Preference.

(*a*) Money or property belonging to a Trustee Savings Bank which has come into the possession of a bankrupt official of the bank by virtue of his office (*Savings Bank Act*, 1863, S. 14).

(*b*) Money or property belonging to a Friendly Society held by a bankrupt official of the Society (*Friendly Societies Act*, 1896, S. 35).

(*c*) Where the estate of a deceased insolvent is being administered according to the laws of bankruptcy, the funeral and testamentary expenses incurred on behalf of the deceased by his legal personal representative (S. 130 (6)).

(*d*) The expenses of a Trustee under a D. of A. that has been avoided by bankruptcy, so far as they were incurred in carrying out the duties imposed by the *D. of A. Act*, 1914.

Preferential Debts.—By SS. 33 and 34, the following debts are

paid after the costs of the bankruptcy have been defrayed and before other unsecured debts.

(*e*) All parochial or other local rates due from the bankrupt at the date of the R.O., and having become due and payable within twelve months next before that time, and all assessed taxes, land tax, property or income tax, assessed on the bankrupt up to the 5th day of April next before the date of the R.O., and not exceeding in the whole one year's assessment. If more than one year's taxes are due, the Revenue Authorities may select any one year as preferential, and rank as unsecured for the balance. Income Tax deducted from interest, etc., not payable or not wholly payable out of profits or gains brought into charge (*Rule* 21, *General Rule*, *Income Tax Act*, 1918), and not handed over to the Revenue at the date of the R.O., can now be assessed under S. 26 *Finance Act*, 1927, and so made preferential.

(*f*) All wages or salary of any clerk or servant in respect of services rendered to the bankrupt during four months before the date of the R.O., not exceeding £50, whether or not earned wholly or in part by way of commission.

(*g*) All wages of any labourer or workman not exceeding £25, in respect of services rendered to the bankrupt during two months before the date of the R.O. Provided that, where any agricultural labourer has entered into a contract for the payment of a portion of his wages in a lump sum at the end of the year of hiring, the priority shall extend to the whole of such sum, or a part thereof, as the Court may decide to be due under the contract, proportionate to the time of service up to the date of the R.O.

(*h*) All amounts due in respect of compensation under the Workmen's Compensation Acts, the liability wherefor accrued before the date of the R.O., if the bankrupt is not insured. The limit of liability, formerly fixed at £100, no longer applies (*Workmen's Compensation Act*, 1923, S. 19). Where the bankrupt is insured the employers' rights against the insurance company are transferred to the workman.

(*i*) All contributions payable by the bankrupt under the Health, and Unemployment Insurance Acts in respect of employed persons during the twelve months before the date of the R.O.

(*j*) Such proportion of the premium paid by or on behalf of an apprentice or articled clerk as the trustee (or, on appeal, the Court) thinks fit, having regard to the unexpired period of service.

Rent.—The landlord is not a preferential creditor, but his claim is usually settled with the preferential debts owing to his power of distress. He can distrain upon the goods or effects of the bankrupt, for the rent due to him from the bankrupt, at any time before or after the commencement of the bankruptcy; but if he distrains after the commencement he can only recover six months' rent accrued due

prior to the adjudication order. He ranks as an unsecured creditor for the balance.

Public Examination.—As soon as possible after the debtor has submitted his Statement of Affairs he is publicly examined in open Court, as to his conduct, dealings, and property. Any creditor who has tendered proof of his debt may question the debtor concerning his affairs and the causes of his failure.

First Meeting of Creditors.—The O.R. must, having given six clear days' notice in the *Gazette* and in a local paper, call a first meeting of creditors to be held not less than fourteen days after the date of the R.O., unless the Court appoints a later day. The O.R. sends to each creditor, mentioned in the Statement of Affairs, notice of the time and place of the meeting, and a copy of the summary statement of affairs—the "front sheet," together with his observations thereon. Forms for proof of debts, and proxies, and a copy of the scheme of composition or arrangement, if any is proposed by the debtor, are also sent to the Creditors.

The debtor must attend the meeting and answer questions put to him. The O.R. or his nominee acts as chairman. The main business of the meeting, after obtaining any information and explanations required from the debtor, is to decide whether the scheme of composition (if any) proposed by the debtor shall be accepted. In order to be binding, such a scheme must receive the assent of a majority in number representing three-fourths in value of *all* the creditors *who have proved* their debts, and must afterwards be sanctioned by the Court. Creditors may assent to, or dissent from, the scheme by means of a *Voting Letter*, which must reach the O.R. the day before the meeting. If no scheme is proposed, or if the scheme proposed is rejected, the creditors then decide whether the debtor shall be adjudicated bankrupt. If they so decide, they may then appoint a *Trustee* and a *Committee of Inspection*. This business is transacted by *Ordinary Resolution*, i.e. a resolution passed by a simple majority in value of the creditors present personally or by proxy at a meeting of creditors, and voting on the resolution. A *Special Resolution* is one decided by a majority in number and representing three-fourths in value of the creditors present personally or by proxy at a meeting of creditors, and voting on the resolution. Special resolutions are necessary (*a*) to remove a *Special Manager*; (*b*) to make an allowance in kind to the bankrupt; (*c*) to resolve that some person other than the O.R. shall, in the case of a small bankruptcy, be appointed Trustee.

Small Bankruptcies.—These are bankruptcies where the assets are not likely to exceed £300. The O.R. acts as Trustee, except as above mentioned. In these bankruptcies, there is no C. of I., advertisements are dispensed with, and the estate is wound up in a summary manner.

Adjudication Order.—Where the creditors pass a resolution that the debtor shall be made bankrupt; or pass no resolution; or do not

meet; or where a scheme is proposed, but is not approved within fourteen days of the conclusion of the public examination, or within such further time as the Court may allow; the Court will adjudge the debtor bankrupt. Thereupon the bankrupt's property vests in the Trustee and becomes divisible among the creditors. Adjudication Orders are advertised in the *Gazette* and in a local paper. Until a Trustee is appointed the property vests in the O.R. The adjudication order may be annulled if a Scheme of Arrangement or Composition is subsequently approved; or if the Court should afterwards decide that the debtor should not have been made bankrupt, and no offences against the bankruptcy laws are proved against him; or if the debts are paid in full. The commencement of the bankruptcy dates back to the date of the act of bankruptcy upon which the petition was founded, or to any previous act of bankruptcy which the trustee can prove to have been committed by the debtor within three months of the date on which the petition was presented. This doctrine of the "relation back" of the bankruptcy to the first available act of bankruptcy is often of the greatest assistance to the Trustee in enabling him to trace and attach the bankrupt's property.

Taking Possession of the Property.—As soon as the Trustee obtains his certificate of appointment, he proceeds to take possession of the bankrupt's property. The only property exempted is :—

(*a*) Property held by the bankrupt on trust for any other person;

(*b*) Trade tools, wearing apparel and bedding to a value not exceeding £20 in all (S. 38). Further:

(*c*) Property of the debtor the ownership of which, in the event of the debtor's bankruptcy, passes to others. But no one can settle his own property upon himself, so as to pass the property to others in the event of his bankruptcy.

(*d*) The benefit of contracts that can only be carried out by the personal skill of the bankrupt, e.g. contracts entered into by an actor, but to no greater extent than is reasonably sufficient to maintain the bankrupt and his family. These personal earnings may include commission earned by the bankrupt, but not the profits of a business, no matter how great the personal skill required for its conduct, e.g. dentistry.

(*e*) Where the bankrupt is a beneficed clergyman, an officer in the army or navy, or a civil servant, so much of the stipend as the bishop of the diocese, or the Court, with the consent of the chief officer of the department under which the stipend is enjoyed, as the case may be, shall reserve to the bankrupt (SS. 50 and 51 [1]).

(*f*) Where the bankrupt is in receipt of a salary or income other than mentioned in (*e*) above, or is entitled to any half-pay, or pension, or to any compensation granted by the Treasury, so much of this income as the Court may permit him to retain (S. 51 [2]).

Upon proof of his appointment, the Trustee becomes possessed

of any stocks or shares held by the bankrupt, and can sell and transfer them. If the shares are not fully paid, the Trustee can disclaim them, and should do so if it is to the benefit of the estate, in which case the company can prove for any outstanding or future calls.

Property Divisible.—The property of the bankrupt divisible amongst the creditors is described by Section 38 as comprising :—

(*a*) All such property as may belong to or be vested in the bankrupt at the commencement of the bankruptcy, and all property that may be acquired by or devolve on him before his discharge ; and the capacity to take proceedings for exercising all such powers in or over or in respect of property as might have been exercised by the bankrupt for his own benefit at the commencement of his bankruptcy or before his discharge, except the right of nomination to a vacant ecclesiastical benefice.

Property acquired by or devolving upon a bankrupt after the commencement of his bankruptcy is known as "After Acquired Property."

(*b*) All goods being, at the commencement of the bankruptcy, in the possession, order, or disposition of the bankrupt, in his trade or business, by the consent and permission of the true owner, under such circumstances that he is the reputed owner thereof, provided that things in action other than debts due or growing due to the bankrupt in the course of his trade or business shall not be deemed goods within the meaning of this section.

Committee of Inspection.—The creditors may, at their first or subsequent meeting, by resolution, appoint a C. of I. to superintend the administration of the estate by the Trustee. The Committee must consist of not less than three or more than five creditors who have proved their debts, or persons holding a general proxy or general power of attorney from such creditors. The C. of I. meets at such times as it may appoint, and, failing appointment, at least once a month. The Committee acts by a majority of its members. The Trustee must have regard to the Committee's instructions, and certain acts can only be done with the Committee's sanction. A member of the C. of I. may be removed by an ordinary resolution of the creditors. Where there is no Committee, the O.R. carries out its duties, subject to the direction of the Board of Trade. Members of the C. of I. are entitled to their expenses, but not to remuneration for their services, except by sanction of the Court. No member may, without leave of the Court, purchase any part of the debtor's estate, or, where the trustee is carrying on the debtor's business, derive any profit from supplying goods to the Trustee.

Proof of Debts.—As soon as possible after the R.O., creditors must prove their debts by lodging with the O.R., or the Trustee, an affidavit made personally or by their authorised agent. Proofs for claims exceeding £2, other than for workers' wages, or Crown debts, must bear a 1s. 6d. Bankruptcy Stamp, or a postal order for that sum must be

sent to the O.R. or the Trustee. A single proof may be made by the debtor, or foreman, or other person on behalf of the workmen, for the total claim in respect of wages owing. Proofs of debt must be admitted or rejected by the Trustee within twenty-eight days of receipt, but where the O.R., or the Trustee, has given notice of his intention to declare a dividend, then within fourteen days of the date mentioned in the notice as the latest date by which proofs must be lodged.

Debts Provable in Bankruptcy.—All debts and liabilities, present or future, certain or contingent, to which the debtor is subject at the date of the R.O., or to which he may become subject before his discharge by reason of any obligation incurred before the date of the R.O., shall be deemed to be debts provable in bankruptcy (S. 30 [3]).

Debts not Provable.—The following are not provable in bankruptcy :—

(*a*) Demands in the nature of unliquidated damages arising otherwise than by reason of a contract, promise, or breach of trust.

(*b*) Debts or liabilities contracted by the debtor with any person who had notice prior to the contraction of the debt that the debtor had committed an available act of bankruptcy.

(*c*) Debts or liabilities, the value of which are, in the opinion of the Court, incapable of being fairly estimated (S. 30 [1], [2], and [6]).

Deferred Debts.—Certain debts, detailed on p. 683, are preferential; other debts are deferred, i.e. they do not rank for payment until the ordinary unsecured creditors have been paid in full. The following are deferred debts :—

(*a*) Money lent under a written contract, signed by, or on behalf of, all the parties thereto, to a person engaged, or about to engage, in business, whereby the lender receives a share of the profits of the business in lieu of interest, or a rate of interest dependent upon the profits. Any security is not affected (*Partnership Act*, 1890, S. 2 [3]).

(*b*) A share of the profits of a business, whether by way of annuity or otherwise, due to a vendor as consideration for the sale by him of the goodwill of the business. Any security is unaffected (*Partnership Act*, 1890, S. 2 [3 (*e*)]).

(*c*) Money or other estate lent or entrusted by a husband to his wife for the purposes of her trade or business (S. 36 [1]).

(*d*) Money or other estate lent or entrusted by a wife to her husband for the purpose of any trade or business carried on by him or otherwise (S. 36 [2]).

(*e*) Money or property contributed by limited partners under a limited partnership agreement are postponed to the claims of the ordinary creditors of the partnership (*Limited Partnership* (*Winding Up*) *Rules*, 1909, 4 [4]).

(*f*) Claims of trustees of a marriage settlement in which the settler covenants for future payments of money, or future settle-

ments of property in which he had, at the time of making the settlement, no estate or interest (S. 42 [2]).

Secured Creditors.—By Rule 5 of the second Schedule to the Act of 1914, every creditor is required to state in his affidavit of proof whether he is or is not a secured creditor. By the *Bankruptcy (Amendment) Act*, 1926, S. 11, a creditor who omits to state that he is secured shall surrender his security, unless the Court allows him to amend his affidavit on such terms as to repayment of any dividends or otherwise as the Court may consider just.

A secured creditor is one who holds a mortgage, charge, or lien on any property of the bankrupt as security for the debt due to him. Such a creditor may ignore the bankruptcy altogether and realise the security, accounting to the Trustee for any surplus remaining after recovery of the amount of the debt with interest and the expense of realising the security. Or he may adopt one of the three courses following :—

(*a*) Surrender his security and prove for the whole debt.

(*b*) Realise his security and prove for any balance that remains undischarged.

(*c*) Estimate the value of his security and prove for the balance.

If the creditor adopts the last-mentioned course, (*c*) above, the Trustee may redeem the security at the creditor's valuation ; or, if he is dissatisfied with the valuation, require the property to be sold, in which case the creditor can prove for any balance remaining after crediting the proceeds of sale. A secured creditor may at any time, by notice in writing, require the Trustee to elect whether he will or will not exercise his right to redeem the security, or to require the property to be sold, and if the Trustee does not within six months of the receipt of the notice signify to the creditor, in writing, that he will exercise either right, then the property vests in the creditor at the estimated value that he has placed upon it.

If the security rests upon the estate of a third person, e.g. a guarantor, or is held on a separate estate against a joint debt, the security need not be valued, and the creditor may prove for the whole debt.

Execution Creditors.—A creditor who has obtained judgment against a debtor may enforce the judgment by levying execution on the land or goods of the debtor, or by attaching debts due to the debtor. No such execution or attachment is valid against the O.R. or the Trustee unless it is completed before the date of the R.O., and before the judgment creditor has had notice of the commission by the debtor of an available act of bankruptcy, or that a bankruptcy petition has been presented by the debtor, or by his creditor or creditors.

Partnership.—Firms, like individuals, are subject to the bankruptcy laws, but limited companies are not. Limited companies are wound up under the *Companies Act*, 1929, and the *Companies (Winding-up) Rules*, 1929. A petition may be presented, and a R.O. be made against

a firm in the firm name, but the adjudication order is made against each partner separately. The partners must prepare a statement of affairs for the partnership, and each partner must prepare a statement of his separate affairs. There is a joint estate of the partnership assets primarily liable for the firm's debts, and the separate estate of each partner primarily liable for each partner's separate debts. The joint partnership estate is first applied in payment of the joint partnership debts, and each partner's separate estate is first applied in payment of his separate debts. Any surplus on a partner's separate estate goes into the joint estate, if there is a deficiency on the joint estate, but the intention to transfer such a surplus must first be advertised in the *Gazette*. Should there be a surplus on the joint estate, it is divided among the separate estates in proportion to the right and interest of each partner in the joint estate. Where a R.O. is made against a firm, both the joint and separate creditors are summoned to the first meeting of creditors. The trustee appointed by the joint creditors acts also as Trustee for the separate estates.

The bankruptcy of one partner of a firm does not necessarily involve the bankruptcy of the firm, but, in the absence of any agreement to the contrary, it dissolves the partnership.

Discharge of Bankrupt.—On conclusion of his public examination, a bankrupt may apply for an order of discharge from bankruptcy. The O.R. gives notice to every creditor of such an application. The Court may at its discretion grant, refuse, or suspend the order, or it may impose conditions prior to granting the order, such as that the bankrupt shall consent to judgment for a fixed amount, the judgment to be satisfied out of the after-acquired property of the bankrupt.

If the bankrupt has been guilty of felony, or any misdemeanour, as specified in SS. 154–158, that will constitute grounds for refusal. The order may also be refused, or, if not refused, may be suspended, where the bankrupt is shown to have failed to keep proper books, or to have continued to trade knowing himself to be insolvent, or to have contributed to his bankruptcy by rash speculation, or unjustifiable extravagance in living, or gambling, or culpable neglect of his business, or where any of the other facts specified in SS. 26 (3) and S. 27 have been proved against him.

Under the Act of 1914, the failure to keep proper books of account might entail the refusal, or the suspension of the order of discharge, or the grant of it only upon terms. It did not amount to a misdemeanour, which may entail not only refusal of the order of discharge, but prosecution as well, unless the bankrupt had previously been adjudged bankrupt, or had previously made a composition or arrangement with his creditors. Now, by the *Bankruptcy (Amendment) Act*, 1926, a person who for the first time becomes bankrupt, or in respect of whose estate a R.O. has been made will, after the 16th June, 1928, be guilty of a misdemeanour if, having been engaged in

any trade or business during any period in the two years immediately preceding the date of the presentation of the bankruptcy petition, he has *not* kept proper books throughout that period and throughout any further period in which he was so engaged between the date of the presentation of the petition and the date of the R.O., or has not preserved all books of account so kept. The only escape from penalty will be proof that the omission to keep proper books is honest and excusable in the circumstances in which he traded, or where, in the case of a first R.O., the unsecured liabilities do not exceed £500, and in any other case £100.

The new Act further provides that, except in respect of retail sales made to the actual consumer, proper accounts must be kept of all sales and purchases with sufficient detail of buyers and sellers to enable the goods and the buyers and sellers thereof to be identified. This is an attempt to prevent "long-firm" frauds. The Act gives the Court unfettered freedom regarding the period during which a bankrupt's discharge may be suspended.

Undischarged Bankrupt.—It is important that a bankrupt should obtain his discharge.

Where an undischarged bankrupt either alone or jointly with any other person obtains credit to the extent of £10 or upwards from any person without informing that person that he is an undischarged bankrupt; or engages in any trade or business under a name other than that under which he was adjudicated bankrupt without disclosing to all persons with whom he enters into any business transaction the name under which he was adjudicated bankrupt: he shall be guilty of a misdemeanour (S. 155).

Official Forms.—The prescribed forms which the debtor must employ when submitting his Statement of Affairs are shown on pp. 692–699.

Illustration.—From the following particulars prepare the Statement of Affairs and the Deficiency Account of S. P. Endthrift. The Deficiency Account is to start at the commencement of business. The R.O. was dated December 31, 1933.

Business Balances, December 31, 1933:—

Capital Account, £635; Trade Creditors, £2,560; Expenses, £140; Rent (one year), £300; Loan on Security of Freehold House, £1,000; Bank Overdraft, £200; Bills Payable, £1,000; Liability on Bills Discounted, £1,500 (Estimated to rank, £350); Income Tax due, 1931–1932, £200, 1932–1933, £50; Rates (six months), £55; Wages of Workmen—Brown (six weeks), £36, Jones (four weeks), £24; Salary of Clerk (three months), £60; Cash in hand, £50; Bills Receivable, £190 (Estimated to produce £150); Freehold House, £1,500; Stock at Cost, £2,000 (Valued at £1,200); Trade Fixtures at Cost, £300 (Valued at £100); Debtors:—Good, £810, Doubtful, £400 (Estimated to produce 25 %), Bad, £1,010.

Private Assets and Liabilities:—Household Furniture, £480; Household Debts, £90; Life Policy for £2,000, Surrender Value, £150, held by Bank as security for overdraft.

The business was commenced on January 1, 1931, with a Capital of £3,000. Profit for 1931, £506; Loss for 1932, £292; Loss for 1933, £779. Drawings were £600 per annum. (*Solution*, pp. 700–1.)

No. 34.—STATEMENT OF AFFAIRS.

(*Title.*)

To the Debtor,—

You are required to fill up, carefully and accurately, this sheet, and such of the several sheets A, B, C, D, E, F, G, H, I, J, and K,* as are applicable showing the state of your affairs on the day on which the Receiving Order was made against you, viz. the .... day of ...., 19... Such sheets, when filled up, will constitute your Statement of Affairs, and must be verified by oath or declaration.

Gross Liabilities. £ s. d.	Liabilities (as stated and estimated by Debtor).	£ s. d.	Expected to Rank. £ s. d.	Assets (as stated and estimated by Debtor).	Estimated to Produce. £ s. d.
	Unsecured creditors as per List A			Property as per List H, viz.:—	
	Creditors fully secured as per List B			(a) Cash at bankers	
	Estimated value of securities			(b) Cash in hand	
	Surplus			(c) Cash deposited with solicitor for costs of petition	
	Less amount thereof carried to Sheet C ..			(d) Stock-in-trade (cost £)	
	Balance thereof to *contra*			(e) Machinery	
	Creditors partly secured as per List C			(f) Trade fixtures, fittings, utensils, etc.	
	Less estimated value of securities	£		(g) Farming stock	
	Liabilities on bills discounted other than debtor's own acceptances for value as per List D, viz.:—			(h) Growing crops and tenant right	
				(i) Furniture	
				(j) Life policies	
				(k) Stocks and shares	
				(l) Reversionary or other interests under wills ..	
				(m) Other property, viz.:—	
				Total as per List H	

	£	s.	d.
On accommodation bills as drawer, acceptor, or indorser			
On other bills as drawer or indorser			
	£		
Of which it is expected will rank against the estate for dividend			
Contingent or other liabilities as per List E	£	:	:
Of which it is expected will rank against the estate for dividend			
	£	s.	d.
Creditors for rent, etc., recoverable by distress as per List F			
Creditors for rates, taxes, wages, etc, payable in full as per List G			
Sheriff's charges payable under S. 41 of the Act, estimated at			
Deducted contra	£		
† Surplus explained in Statement K			
	£		

	£	s.	d.
Book debts as per List I, viz.:—			
Good			
Doubtful			
Bad			
	£		
Estimated to produce..			
Bills of exchange or other similar securities on hand as per List J	£	:	:
Estimated to produce..			
Surplus from securities in the hands of creditors fully secured (*per contra*)..			
	£		
Deduct creditors for distrainable rent and for preferential rates, taxes, wages, sheriff's charges, etc (*per contra*)			
	£		
† Deficiency explained in Statement K			
	£		

I .... of .... in the County of .... make oath and say that the above statement and the several lists hereunto annexed marked .... are, to the best of my knowledge and belief, a full, true, and complete statement of my affairs on the date of the above-mentioned receiving order made against me.

Sworn at ....
in the County of ....
this ...... day of ...., 19..,
Before me, ...

(*Signature*) ....

* Sheet L should be substituted for any one or more of such of the sheets named as will have to be returned blank.
† Strike out words which do not apply.

No. 34.

A.—UNSECURED CREDITORS.

The Names to be arranged in alphabetical order and numbered consecutively, Creditors for £10 and upwards being placed first.

No	Name.	Address and Occupation	Amount of Debt.			Date when Contracted.		Consideration.
			£	s.	d.	Month.	Year.	

Signature ....

Dated .... 19...

NOTES.—1. When there is a contra account against the creditor, less than the amount of his claim against the estate, the amount of the creditor's claim and the amount of the contra account should be shown in the third column, and the balance only be inserted under the heading "Amount of Debt," thus :—

	£	s.	d.
Total amount of claim		:	:
Less contra account		:	:
		:	:

No such set-off should be included in Sheet I.

2. The particulars of any bills of exchange and promissory notes held by a creditor should be inserted immediately below the name and address of such creditor.

No. 34.

B.—CREDITORS FULLY SECURED.

No.	Name of Creditor	Address and Occupation.	Amount of Debt.			Date when Contracted.		Consideration.	Particulars of Security.	Date when given.	Estimated Value of Security.			Estimated Surplus from Security.		
						Month.	Year.									
			£	s.	d.						£	s.	d	£	s	d.

Signature ....

Dated .... 19...

No. 34.

C.—CREDITORS PARTLY SECURED.

No.	Name of Creditor.	Address and Occupation.	Amount of Debt			Date when Contracted.		Consideration.	Particulars of Security.	Month and Year when given.	Estimated Value of Security.			Balance of Debt Unsecured.		
						Month.	Year.									
			£	s.	d.						£	s.	d	£	s.	d.

Signature ....

Dated .... 19...

No. 34.

D.—LIABILITIES OF DEBTOR ON BILLS DISCOUNTED OTHER THAN HIS OWN ACCEPTANCES FOR VALUE.

No.	Acceptor's Name, Address, and Occupation.	Whether liable as Drawer or Indorser.	Date when due.	Amount.						Holder's Name, Address, and Occupation (if known).	Amount expected to rank against Estate for Dividend.		
				Accommodation Bills.			Other Bills.						
				£	s.	d.	£	s.	d.		£	s.	d.

Signature ....

Dated .... 19...

No. 34.

E.—CONTINGENT OR OTHER LIABILITIES.

(Full particulars of all Liabilities not otherwise scheduled to be given here.)

No.	Name of Creditor or Claimant.	Address and Occupation.	Amount of Liability or Claim.			Amount expected to rank for Dividend.			Date when Liability incurred.		Nature of Liability.
			£	s.	d.	£	s.	d.	Month.	Year.	

Signature ....

Dated .... 19...

No. 34.

F.—CREDITORS FOR RENT, ETC., RECOVERABLE BY DISTRESS.

No.	Name of Creditor.	Address and Occupation.	Nature of Claim.	Period during which Claim accrued due.	Date when due.	Amount of Claim.			Amount recoverable by distress.			Difference ranking for Dividend (to be carried to List A).		
						£	s.	d.	£	s	d.	£	s.	d.

Signature ....

Dated .... 19...

No. 34.

G.—PREFERENTIAL CREDITORS FOR RATES, TAXES, AND WAGES.

No.	Name of Creditor.	Address and Occupation.	Nature of Claim	Period during which Claim accrued due.	Date when due.	Amount of Claim.			Amount payable in full.			Difference ranking for Dividend (to be carried to List A).		
						£	s.	d.	£	s.	d.	£	s.	d.

Signature ....

Dated .... 19...

No. 34.

H.—PROPERTY.

Full particulars of every description of Property in possession and in reversion as defined by Section 167 of the Act, not included in any other list, are to be set forth in this list.

Full Statement and Nature of Property.	Estimated to produce. £	s.	d
(a) Cash at bankers			
(b) Cash in hand			
(c) Cash deposited with solicitor for costs of petition			
(d) Stock-in-trade at .. .. Cost £ : :			
(e) Machinery at			
(f) Trade fixtures, fittings, utensils, etc., at			
(g) Farming stock at			
(h) Growing crops and tenant right at			
(i) Household furniture and effects at			
(j) Life policies			
(k) Stocks and shares			
(l) Reversionary or other interests under wills, etc.			
(m) Other property (state particulars), viz.			

Signature .... *Dated* .... 19...

No. 34.

I.—DEBTS DUE TO THE ESTATE.

No.	Name of Debtor.	Residence and Occupation.	Amount of Debt. Good. £	s.	d.	Doubtful. £	s.	d.	Bad. £	s.	d	Folio of Ledger or other Book where Particulars to be found.	When Contracted. Month.	Year.	Estimated to produce. £	s.	d.	Particulars of any Securities held for Debt.

Signature .... *Dated* .... 19...

NOTE.—If any debtor to the estate is also a creditor, *but for a less amount than his indebtedness*, the gross amount due to the estate and the amount of the contra account should be shown in the third column, and the balance only be inserted under the heading "Amount of Debt" thus :—

	£	s.	d.
Due to estate		:	:
Less contra account		:	:

No such claim should be included in Sheet A.

No. 34. J.—BILLS OF EXCHANGE, PROMISSORY NOTES, ETC., AVAILABLE AS ASSETS.

No	Name of Acceptor of Bill or Note.	Address, etc.	Amount of Bill or Note.			Date when due.	Estimated to produce.			Particulars of any Property held as security for Payment of Bill or Note.
			£	s.	d.		£	s.	d.	

Signature .... *Dated* .... 19...

No. 34. K.—DEFICIENCY (OR SURPLUS) ACCOUNT.

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Excess of assets over liabilities on the * ... day of....19.. (if any)							Excess of liabilities over assets on the *... day of....19.. (if any)						
Net profit (if any) arising from carrying on business from the *......day of...... 19.., to date of Receiving Order, after deducting usual trade expenses							Net loss (if any) arising from carrying on business from the *......day of...... 19.., to date of Receiving Order, after charging against profits the usual trade expenses						
Income or profit from other sources (if any) since the *....day of....19..							Bad debts (if any) as per Schedule I † .						
Gifts from relations and others							Depreciation of stock-in-trade						
‖ Deficiency as per Statement of Affairs ..							Depreciation of machinery						
							Depreciation of trade fixtures, fittings, etc.						
							Expenses incurred since the *... day of ....19...,other than usual trade expenses, viz. household and personal expenses of self and ‡.....						
							§ Other losses and expenses (if any)						
							‖ Surplus as per Statement of Affairs ..						
Total amount to be accounted for ¶.. .. .. £							Total amount accounted for ¶ .. .. £						

Signature .... *Dated* .... 19...

* This date should be twelve months before date of receiving order, or such other time as Official Receiver may have fixed.
† This Schedule must show when debts were contracted. ‡ Add "wife and children" (if any), stating number of latter.
§ Here add particulars of other losses or expenses (if any), including liabilities (if any) for which no consideration received.
‖ Strike out words which do not apply. ¶ These figures should agree.

Re S. P. ENDTHRIFT.

STATEMENT OF AFFAIRS

AT DECEMBER 31, 1933, DATE OF RECEIVING ORDER.

Gross Liabilities £	s.	d.	Liabilities (as stated and estimated by Debtor).	£	s.	d.	Expected to rank. £	s.	d.
4,011	0	0	Unsecured Creditors as per List A				4,011	0	0
1,000	0	0	Creditors fully secured as per List B	1,000	0	0			
			Estimated value of securities	1,500	0	0			
			Surplus to contra	500	0	0			
200	0	0	Creditors partly secured as per List C	200	0	0			
			Less estimated value of securities	150	0	0	50	0	0
1,500	0	0	Liabilities on Bills discounted other than Debtor's own acceptances for value as per List D ..	1,500	0	0			
			Expected to rank				350	0	0
			Creditors for rent, etc., recoverable by distress as per List F	150	0	0			
			Creditors for rates, taxes, wages, etc., payable in full as per List G	354	0	0			
504	0	0	Deducted contra	504	0	0			
£7,215	0	0	£				4,411	0	0

Assets (as stated and estimated by Debtor).	£	s.	d.	Estimated to produce. £	s.	d.
Property as per List H, viz.:—						
Cash in hand				50	0	0
Stock-in-trade (cost £2,000)				1,200	0	0
Trade fixtures				100	0	0
Furniture				480	0	0
Total as per List H				1,830	0	0
Book debts as per List L, viz.:—						
Good				810	0	0
Doubtful	400	0	0			
Bad	1,010	0	0			
	1,410	0	0			
Estimated to produce				100	0	0
Bills of Exchange or other similar securities as per List J £190 0 0						
Estimated to produce				150	0	0
Surplus from securities in the hands of creditors fully secured (per contra)				500	0	0
				3,390	0	0
Deduct creditors for distrainable rent, and for preferential rates, taxes, wages, etc. (per contra) ..				504	0	0
				2,886	0	0
Deficiency as explained in statement, List K				1,525	0	0
£				4,411	0	0

LIST (K).—DEFICIENCY (OR SURPLUS) ACCOUNT.

	£	s.	d.		£	s.	d.
Excess of Assets over Liabilities on January 1, 1931	3,000	0	0	Net Loss arising from carrying on business from January 1, 1931, to December 31, 1933, after deducting usual Trade Expenses— For the year 1932 .. .. £292 For the year 1933 779	1,071	0	0
Net Profit arising from carrying on business from January 1, 1931, to December 31, 1933, after deducting usual Trade Expenses	506	0	0	Bad Debts as per Schedule I ..	1,310	0	0
Income or Profit from other sources since January 1, 1931 :— Private Assets brought in : Life Policy .. .. £150 Household Furniture .. 480	630	0	0	Depreciation of Stock-in-trade ..	800	0	0
Deficiency as per Statement of Affairs	1,525	0	0	Depreciation of Trade Fixtures ..	200	0	0
				Expenses incurred since January 1, 1931, other than the usual Trade Expenses, viz household expenses of self and wife and three children	1,890	0	0
				Other losses and expenses :— Estimated loss on Bill Receivable Discounted	350	0	0
				Estimated loss on realisation of *Bills Receivable*	40	0	0
£	5,661	0	0	£	5,661	0	0

NOTES.—(1) The Unsecured Creditors are composed of :—

	£	s.	d.
Trade	2,560	0	0
Expenses	140	0	0
Rent (six months)	150	0	0
Bills Payable	1,000	0	0
Income Tax, 1932/1933	50	0	0
Wages—Brown (in excess of £25)	11	0	0
Salary in excess of £50	10	0	0
Household Debts	90	0	0
	£4,011	0	0

(2) The Preferential Creditors are restricted as follows :—

	£	s.	d.
Rent (only six months recoverable by distraint) ..	150	0	0
Income Tax (only one year preferential, but any one year may be chosen), 1931/1932	200	0	0
Brown, workmen's wages (not to exceed £25 in respect of any one workman)	25	0	0
Jones	24	0	0
Salary (not to exceed £50 in respect of any clerk or servant)	50	0	0
Rates	55	0	0
	£504	0	0

The balances are included with the unsecured creditors.

(3) Subject to the costs of the bankruptcy, there is £2,886 available to meet the claims of unsecured creditors, amounting to £4,411.

THE TRUSTEE.

Appointment.—After the debtor has been adjudicated bankrupt, the O.R. acts as Trustee until some other person is appointed so to act. Any person may be appointed by the creditors by ordinary resolution, or they may leave the appointment to the C. of I. The Board of Trade may object to the person appointed if his connection with the debtor, or any creditor, or his personal interest in the debtor's estate would make it difficult for him to act impartially ; or if he has previously been removed from a trusteeship for misconduct ; or if his appointment was irregular. Should the creditors fail to appoint a Trustee, the Board of Trade may do so, but the creditors or the C. of I. may, at any time, substitute their own for the Board's nominee. The Trustee's appointment must be gazetted and advertised in a local paper. A Trustee is required to give such security as the Board of Trade may require, and with the creditors' consent the premium on the guarantee bond may be charged against the estate. The amount of the bond may be reduced from time to time with the consent of the Board of Trade.

Duties.—The Trustee's duties are to take possession of the debtor's property, realise it, and apply the proceeds in paying (*a*) the costs of the bankruptcy, including his own remuneration, (*b*) the creditors, and (*c*) returning any surplus to the debtor.

Powers.—By S. 54, where any part of the property of the bankrupt consists of land of any tenure burdened with onerous covenants, of shares or stock in companies, of unprofitable contracts, or of any other property that is unsaleable, or not readily saleable, by reason of its binding the possessor thereof to the performance of any onerous act, or to the payment of any sum of money, the trustee, notwithstanding that he has endeavoured to sell or has taken possession of the property, or exercised any act of ownership in relation thereto, may, by writing signed by him, at any time within twelve months after the first appointment of a trustee, disclaim the property ; provided that where any such property has not come to the knowledge of the trustee within one month after such appointment, he may disclaim such property at any time within twelve months after he has become aware thereof or such extended period as may be allowed by the Court. This power is known as the *right of disclaimer*, and its effect is to determine, as from the date of disclaimer, the bankrupt's rights and liabilities in respect of the property disclaimed, and also to discharge the trustee from all personal liability in respect of the property as from the date when the property vested in him.

By S. 55, a Trustee has power to sell the bankrupt's property by auction or private contract ; to execute powers of attorney, deeds, and other instruments ; to deal with any entailed property to which the bankrupt is beneficially entitled in the same manner as the bankrupt

might have dealt with it; to apply to the Court for direction in cases of need, etc., as set out in the section.

By S. 56, the Trustee may exercise other powers, but only with the permission of the C. of I. These include power to carry on the bankrupt's business so far as it may be necessary for the beneficial winding-up of the estate; to bring or defend actions relating to the bankrupt's property; to employ a solicitor or other agent to take any proceedings or do any business sanctioned by the C. of I.; to compromise with creditors, etc., as detailed in the section.

Remuneration.—The creditors, by ordinary resolution, may fix the Trustee's remuneration, or they may leave it to the C. of I. It must take the form of a commission or percentage, of which one part is payable on the amount realised by the Trustee, after deducting any sums paid to secured creditors out of the proceeds of their securities, and the other part on the amount distributed in dividends.

Dividends.—The first dividend must be declared and distributed within four months following the conclusion of the first meeting of creditors, unless the trustee satisfies the C. of I. that there is sufficient reason for postponement. Subsequent dividends must, in the absence of adequate reasons for not doing so, be declared and distributed at intervals of not less than six months.

Final Dividend and Release.—When the Trustee has realised all the property of the bankrupt, or so much thereof as, in the joint opinion of himself and the C. of I., can be realised without needlessly protracting the trusteeship, he must declare a final dividend. Having distributed this dividend, or whenever for any other reason his trusteeship terminates, e.g. by resignation, or removal by the Board of Trade, he may apply for his release. Before doing so, he must give notice to all creditors who have proved their debts, and must send with the notice a summary of his receipts and payments as Trustee. The order granting the release must be gazetted, and is not effectual until the Trustee has delivered to the O.R. all books, papers, documents, and accounts relating to the bankruptcy.

Unclaimed dividends must, after the expiration of six months, be paid into the Bankruptcy Estates Account at the Bank of England.

Fraudulent Preference.—One of the objects of bankruptcy law is to secure a rateable division of the debtor's estate amongst his creditors by preventing a debtor from paying one creditor to the prejudice of others. So every payment made, or transfer of, or charge on, property given, to a creditor by a debtor who is unable to pay his debts as they become due is void against the Trustee if the debtor is adjudged bankrupt on a petition presented within three months from the date when the payment was made, or the transfer or charge was executed. To make such a payment, transfer, or charge void, the dominant

ESTATE CASH BOOK.

Date.	Particulars.	Receipts.																	
		Total			Drawn from Bank.			Debts Collected.			Property Realised.			Receipts from Securities held by Creditors.			Other Receipts.		
		£	s.	d	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.

ESTATE CASH BOOK—*continued*.

Payments.																				
Date.	Particulars.	Voucher Nos. (in red).	Total.			Paid into Bank.			Costs of Realisation.											
									Board of Trade and Court Fees.			Law Costs of Petition (including £5 Stamp).			Law Costs after Receiving Order.					
			£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.			

ESTATE CASH BOOK—*continued.*

PAYMENTS—*continued.*																										
COSTS OF REALISATION—*continued.*															Allowance to Debtor.			Preferential Creditors (Section 40) and Rent.			Payments to redeem Securities.			Dividends Paid.			Other Payments
Commission on Realisation and Distribution.						Charges of Auctioneer, Accountant, Shorthand Writer, etc., as taxed			Notices in *Gazette* and Local Paper.			Incidental Expenses, including Possession.															
Board of Trade.			Trustees.																							
£	s.	d.	£	s.	d	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.

motive of the debtor must be to give a preference. If the creditor puts pressure on the debtor by taking legal proceedings against him, the Trustee will not be able to set aside the payment; nor is there a fraudulent preference where it is the debtor's object to save himself

(*Trading Account.*)

THE BANKRUPTCY ACT, 1914.

IN THE HIGH COURT OF JUSTICE.

IN BANKRUPTCY.

No. .... of 19...

Re ...., a Bankrupt.

...................., the Trustee of the property of the Bankrupt in account with the Estate.

DR. CR.

Date.	Receipts.	£	s.	d.	Date.	Payments.	£	s.	d

................., Trustee.
Date .... 19...

We have examined this Account with the vouchers, and find the same correct, and we are of opinion that the expenditure has been proper.

....
.... Committee of Inspection.
....

from exposure or prosecution, or to revive an undisputed debt, or make good a breach of trust.

BOOKS AND ACCOUNTS.

Record Book.—Prior to the appointment of the Trustee, the O.R. will open the *Record Book*, for the purpose of recording all resolutions and minutes of meetings, copies of notices and other

documents, and all such papers, except confidential documents, as may be necessary to furnish a true history of the administration of the estate.

Cash Book.—The O.R. will also have opened the Cash Book, a ruling of which is shown on pp. 704–5. All moneys received must be paid into the *Bankruptcy Estates Account* at the Bank of England, unless the Board of Trade, on the application of the C. of I., allows an account to be opened at a local bank.

Trading Account.—If the business of the debtor is carried on, a Trading Account must be kept. This is on a cash basis as shown on p. 706. The weekly totals of this account are incorporated in the "Other Receipts" and "Other Payments" columns of the Cash Book.

Audit of Trustee's Accounts.—The Trustee must submit his books, accounts, and vouchers to the C. of I. at least once every three months, and the Committee must audit the Cash Book and append its certificate thereto on the day of auditing.

At the expiration of six months from the date of the R.O., and at the expiration of every succeeding six months thereafter until his release, the Trustee must transmit to the Board of Trade for audit a copy of the Cash Book in duplicate for such periods, together with the necessary vouchers and copies of the audit certificates of the C. of I. The Trustee is also required to forward at the first audit of his accounts by the Board of Trade an office copy of the front sheet (the summary) of the debtor's Statement of Affairs, and of sheets B, C, F, G, and H, showing thereon, in red ink, the amounts received, and explaining the cause of the non-realisation of such assets as may remain unrealised. At each audit, the Trustee must forward a report on the position of the estate.

Accounts to Creditors.—A statement showing the position of the estate must be sent to each creditor together with the notice declaring a dividend. A final statement of the position of the bankruptcy also accompanies the notice to creditors of the trustee's intention to apply for his release, and usually it is joined to the notice declaring a final dividend. Any creditor may, with the concurrence of one-sixth of the creditors (including himself), at any time call upon the Trustee, or O.R., to furnish and transmit to the creditors a statement of the Accounts up to the date of such notice. The official form appears on pp. 708–9.

Illustration.—In the matter of the estate of S. P. Endthrift (see p. 700). the Trustee was authorised by the C. of I. to postpone the declaration of a dividend until the whole estate had been realised. A first and final dividend was accordingly declared on August 30, 19... The Trustee's remuneration was fixed at 3 % on the amount realised and 2 % on the amount distributed in dividend. On p. 710 is given the statement accompanying the notice of the final dividend and the application for release.

(Statement to accompany Notice of Dividend and Application for Release.)

THE BANKRUPTCY ACT, 1914.

IN THE HIGH COURT OF JUSTICE.

IN BANKRUPTCY.

No. .... of 19...

IN THE MATTER OF ...., of ...., under Receiving Order dated ....

STATEMENT showing the position of the estate at date of declaring the first dividend.

DR. CR.

	Estimated to produce per Debtor's Statement.			Receipts.							Payments.		
	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
To Total Receipts from date of receiving order, viz.:—*							By Board of Trade and Court Fees (including stamp of £5 on petition) ..						
Receipts per Trading Account							,, Law Costs						
Other Receipts							,, Trustee's *remuneration* as fixed by the creditors†						
							,, Other costs						
Total	£			£									

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Less—							,, Allowance to debtor						
Deposit returned to Petitioner							,, Creditors, viz. :—						
Payments to redeem securities							‡ Preferential ..						
Costs of execution							‡ Unsecured § dividend now declared of .... in the £ on ..						
Payments per Trading Account							Dividends previously declared						
Net realisations				£			Balance				£		
				£									

By S. 82 (2) of the *Bankruptcy Act*, 1914, it is provided that " if one-fourth in number or value of creditors dissent from the resolution, or the bankrupt satisfies the Board of Trade that the remuneration is unnecessarily large, the Board of Trade shall fix the amount of the remuneration."

Assets not yet realised estimated to produce ....

‖ Creditors can obtain any further information by inquiry at the Office of the Trustee.

Dated this .... 19..

.... Trustee.

....

....

* State particulars under the several headings specified in the Debtor's Statement of Affairs.
† " Creditors " or " Committee of Inspection " or " Board of Trade," or as the case may be.
‡ Insert number of creditors. § " 1st," or as the case may be.
‖ Add any special remarks the Trustee thinks desirable.

NOTE.—When this Statement accompanies a declaration of a second or subsequent dividend, it shall incorporate the figures of the preceding Statement or Statements under their respective headings.

TRUSTEE'S FINAL SUMMARY OF RECEIPTS AND PAYMENTS.

Dr.

	Estimated to produce as per Debtor's Statement. £	s.	d.	Realised to date. £	s.	d
To Total Receipts from date of Receiving Order, viz.:—						
" Deposit on Petition				5	0	0
" Cash in hand	50	0	0	50	0	0
" Cash deposited with Solicitor						
" Stock-in-trade	1,200	0	0	1,110	0	0
" Fixtures and Fittings	100	0	0	135	0	0
" Book Debts	910	0	0	1,005	0	0
" Bills of Exchange	150	0	0	160	0	0
" Household Furniture	480	0	0	390	0	0
" Surplus from Secured Creditors	500	0	0	500	0	0
" Receipts as per Trading Account						
" Other Receipts						
Total	£3,390	0	0	£3,355	0	0
Less—						
Deposit returned to Petitioner	5	0	0			
Payments to redeem Securities						
Cost of Execution						
Payments as per Trading Account				5	0	0
Net Realisations				£3,350	0	0
				£3,350	0	0

Cr.

		Payments. £	s.	d
By Board of Trade and Court Fees (including Stamp on Petition)		65	0	0
" Law Costs of Petition	£10 0 0			
" Other Law Costs	15 0 0	25	0	0
" Trustee's Remuneration as fixed by the Committee of Inspection, viz:—				
3% on £3,300 (assets realised)	£99 0 0			
2% on £2,500 (assets distributed in dividend)	50 0 0	149	0	0
" Special Manager's Charges				
" Person appointed to assist Debtor under Sec. 74		5	0	0
" Auctioneer's Charges as taxed		29	0	0
" Other taxed Costs				
" Costs of Possession				
" Costs of Notices in *Gazette*		4	0	0
" Incidental Outlay		19	0	0
Total Cost of Realisation		296	0	0
" Allowance to Debtor		50	0	0
" Creditors:—				
Preferential	£504 0 0			
Unsecured	2,500 0 0	3,004	0	0
Dividend now declared of 10s. 5d. in the £ on £4,800.				
N.B.—The debtor's estimate of the amount expected to rank for dividend was £4,411.				
		£3,350	0	0

By Sec. 82 (2) of the *Bankruptcy Act*, 1914, it is provided that "if one-fourth in number of or value of creditors dissent from the resolution, or the bankrupt satisfies the Board of Trade that the remuneration is unnecessarily large, the Board of Trade shall fix the amount of the remuneration."

Creditors can obtain any further information by inquiry at the Office of the Trustee.

Dated this .... day of ...., 19... .... Trustee.

1816, East Street, London, E.C. 1.

Deeds of Arrangement.

Arrangements are frequently made between insolvent debtors and their creditors without invoking the aid of the bankruptcy laws. The object of these arrangements is to avoid the publicity, expense, and stigma of bankruptcy proceedings.

Usually, a formal deed is drawn up and a Trustee appointed. The usual terms of a *Deed of Assignment* provide that the debtor shall assign all his property, or so much thereof as is specified in the deed, to a trustee in trust to realise the property, pay the expenses of realisation, and divide the balance rateably, as in bankruptcy, among the creditors assenting to the deed. In consideration, the creditors undertake to release the debtor from the unpaid balance of their claims. Or the agreement may take the form of a *Deed of Composition*, under which the creditors agree to accept a portion only of the amount due to them, payable by stated instalments, and agree not to sue unless default is made, and to release the debtor from his liabilities on payment.

Only such creditors as assent to deeds of this kind are bound by them, whereas bankruptcy automatically concerns all creditors whose debts are provable in the bankruptcy. Moreover, as the execution of these deeds usually amounts to an act of bankruptcy on the part of the debtor, any creditor whose debt exceeds £50, and who has not assented to the deed, can bring it to naught by presenting a bankruptcy petition against the debtor. If a R.O. is made within three months of the execution of the deed, the deed becomes void, and the Trustee under the deed must account to the Trustee under the bankruptcy for all moneys, etc., received on behalf of the debtor's estate.

Deeds of Arrangement are governed by the *Deeds of Arrangement Act*, 1914, and the *Rules* made pursuant thereto. The Act provides that a D. of A. is void unless it is registered with the Registrar of Bills of Sale within seven clear days after the first execution thereof by the debtor or any creditor. Further, if the deed is expressed to be, or in fact is, for the benefit of the debtor's creditors generally, it is void unless, within twenty-one days of registration, a majority in number and value of the creditors have assented to the deed.

The Act further provides for the giving of security by the Trustee unless this precaution is dispensed with by a majority in number and value of the creditors.

The Trustee must annually transmit to the Board of Trade, within thirty days of the anniversary of the date of the registration of the deed, an account of his receipts and payments. Where the business of the debtor is carried on, he must keep a separate account of the trading receipts and payments, and carry the totals into the yearly account. Distributions of dividend, or instalments of composition, must be entered in the Trustee's Account in one sum, and be supported by a

statement showing the claim of each creditor, and the amount of dividend or composition due to each, distinguishing between those paid and those unpaid.

When a debtor intends to propose a scheme of arrangement or composition to his creditors, it is usual for a Statement of Affairs to be drawn up on similar lines to the Statement of Affairs in bankruptcy, but no official form is prescribed for the statement. When prepared, the statement is submitted to a meeting of the creditors, together with particulars of the scheme proposed. These private schemes must not be confused with schemes officially sanctioned by the Court in bankruptcy. The following is a common form of Statement of Affairs in these cases.

Name ....
Address ....

DEBTOR'S STATEMENT OF AFFAIRS.

Date ....

Liabilities.	£	s.	d.	£	s.	d.	Assets.	£	s.	d.	£	s.	d.
Unsecured Creditors :—							Cash in hand						
Trade							Cash at Bank						
Cash							Stock-in-trade, at cost						
							Book Debts :—						
Creditors fully secured							Good						
Estimated Value of Security							Doubtful						
							Bad						
Surplus to contra £							£						
							Estimated to realise						
							Plant and Machinery						
Creditors partly secured							Trade Fixtures and Fittings						
Less Estimated Value of Security ..							Household Furniture						
							Life Policies						
Liabilities on Bills discounted, of which it is expected will rank against the Estate for Dividend							*Bills of Exchange or other Securities, estimated to produce* ..						
Contingent or other Liabilities ..							Surplus from Securities in hands of Creditors, see contra						
Creditors for Rent, Rates, Taxes, and Wages, deducted from contra Surplus							Other Assets						
							Deduct Preferential Claims, as per contra..						
							Deficiency..						
£							£						

EXAMINATION QUESTIONS.

1. State the ground on which a person can be made bankrupt, and to what persons the bankruptcy laws apply. (*Royal Society Arts.*)

2. State any three "acts of bankruptcy" upon which a petition can be founded. (*Central Association Accountants.*)

3. Summarise the cases in which a debtor commits an act of bankruptcy. (*Royal Society Arts.*)

4. When is the Official Receiver trustee in a bankruptcy? (*Chartered* (*Accountants.*)

5. In what circumstances will an adjudication in bankruptcy follow the making of a receiving order against a debtor? What will be the immediate effect of the adjudication as regards the property of the debtor? (*Chartered Accountants.*)

6. Give specimens of the forms of accounts to be used in the Statement of Affairs required to be filed by a bankrupt. (*Chartered Accountants.*)

7. Describe the differences which exist between a Statement of Affairs and a Balance Sheet. Give a specimen of the former account, and explain how it is prepared. (*Royal Society Arts.*)

8. Sketch the "Summary Sheet" and the "Deficiency Account" of the Statement of Affairs. Supposing the debtor shows a surplus of assets over liabilities, is the Deficiency Account still required to be rendered, and how should it be set out? (*Chartered Accountants.*)

9. Robert Blank has filed a petition in bankruptcy. He has prepared a Statement of Affairs which discloses a deficiency of £3,876. Is any further statement necessary? If so, submit a *pro-forma* account based upon figures which explain the above deficiency. (*Royal Society Arts.*)

10. What classes of creditors are entitled to preferred treatment in bankruptcy, and in what order do they rank for payment? (*Central Association Accountants.*)

11. Before his bankruptcy the debtor owed £50 to a workman in his employment as compensation for injuries; he also owed £20 for rates, and £10 to his servant for wages. Should the trustee give these debts any priority over ordinary debts, and, if so, in what order should they rank for payment? (*Central Association Accountants.*)

12. Distinguish between a deed of arrangement and a scheme of composition in bankruptcy, particularly with reference to the extent of the control to be exercised by the Board of Trade in either case. (*Incorporated Accountants.*)

13. What power have the creditors to accept a composition or scheme after an adjudication of bankruptcy, and what proceedings and consequences follow upon its adoption? (*Incorporated Accountants.*)

14. State the provisions of the Deeds of Arrangement Act, 1914, as to (*a*) the transmission of the trustees' accounts to creditors; and (*b*) the audit of his accounts. (*Incorporated Accountants.*)

15. On what grounds may the Board of Trade object to the appointment of a trustee in bankruptcy, and in what manner may the validity of such objection be tested? (*Incorporated Accountants.*)

16. What power has a trustee in bankruptcy to disclaim any and what portions of the property vested in him? In what manner, and within what time, must such disclaimer be exercised? (*Incorporated Accountants.*)

17. Give a skeleton of the account which a trustee in a bankruptcy must send with the notice of a final dividend. (*Chartered Accountants.*)

18. What books and accounts must be kept by a trustee in bankruptcy, and by whom and how often are they to be audited? (*Chartered Accountants.*)

19. What facts or figures should be shown by the trustee in the Record Book, and how do the Bankruptcy Rules provide for its audit and inspection? (*Central Association Accountants.*)

20. Give the headings (without rulings) of the Cash Account of a trustee in bankruptcy to be filed with the Board of Trade. State shortly in what manner you would consider the form might be amended or simplified. (*Chartered Accountants.*)

21. A bankrupt wishes to obtain his discharge. State shortly (*a*) the steps he must take to obtain such an order, and (*b*) the effect of the order when obtained. (*Incorporated Accountants.*)

22. Give a short account of bankruptcy proceedings from the time when they are started until the discharge of the bankrupt. (*Chartered Institute Secretaries.*)

23. Prepare A B's Statement of Affairs from the following particulars:—
Assets: Cash, £7; Household Furniture, valued at £50; Sundry Debtors (Good, £50; Doubtful, £600, estimated to realise £300), £1,500; Investments (estimated to realise £493), £400. Liabilities: Debts—Fully Secured (security expected to realise £1,600), £1,000; Partly Secured (security expected to realise £2,500), £3,000; Unsecured Creditors, £1,800; Last Quarter's Rent, £50; Last Month's Salaries, £100.

The excess of assets over liabilities on January 1st, the last occasion when his books were balanced, was £500. A B attributes his insolvency to loss on trading, and places his household expenses since January 1st at £350. Show the dividend which may be expected by the creditors after allowing for £100 costs. (*Central Association Accountants.*)

24. What is the position of an undischarged bankrupt as regards obtaining credit and engaging in trade? (*Chartered Accountants.*)

25 X Y Z filed his Petition in Bankruptcy on January 13th. Prepare the front sheet of his Statement of Affairs from the following particulars:—

Unsecured Creditors, £36,942; Fully Secured Creditors, £5,000, secured by a Mortgage on the Debtor's Freehold Factory which he values at £7,500; Partly Secured Creditors, £8,762, secured by the deposit of forty 5 % War Loan Bearer Bonds of £100 each (market price, $84\frac{1}{16}$); Liability as indorser of an Accommodation Bill for £850, expected to rank in full; Rates and Taxes due, £78.

The debtor stated his Assets as follows: Cash in hand, £12; Cash at Bank, £10; Book Debts—Good, £9,682; Doubtful, £3,642, estimated to be worth 7s. 6d. in the £; Stock-in-trade, valued at £2,642; Machinery and Plant, valued at £4,241; Life Policy, surrender value, £325; Bill Receivable, estimated to produce £100. (*Royal Society Arts.*)

26. From the undermentioned particulars prepare the Statement of Affairs of W. & Co. as at September 30th.

Unsecured Creditors, £13,000; Cash in hand, £50; Bills Receivable, £170, estimated to produce £100; Book Debts—Good, £2,500; Doubtful (estimated to produce £3,750), £5,000; Creditors Partly Secured, £6,000, value of security, £4,000; Creditors Fully Secured, £9,500 (value of security held, £12,000); Stock-in-trade (estimated to produce £3,750), £4,250; Preferential Creditors—Rent, £1,350 (annual rent, £1,200); Manager's Salary (for nine months), £750; Investments, estimated to produce £900; Contingent liability on uncompleted Contract, £1,500. (*Incorporated Accountants.*)

27. From the undermentioned particulars prepare Statement of Affairs and Deficiency Account of A B as at September 30, 19.., for submission to his Creditors:—

Creditors Unsecured, £150,000; Creditors Partly Secured, £80,000; Creditors Fully Secured, £200; Liability on Bills Receivable (estimated to rank in full), £7,000; Mortgage on Freehold Premises, £20,000; Preferential Creditors, £6,000; Debtors—Good, £40,000; Doubtful (estimated to produce £4,000), £20,000; Consignments (good), £10,000; Stock (estimated to produce £20,000), £80,000; Shares (good), £32,000; Cash, £3,000; Freehold Premises (estimated to produce £28,500), £29,000; Machinery (estimated to produce £24,000), £30,000; Fixtures (estimated to produce £3,000), £6,000.

A B's Capital on previous October 1 was £100,000. The profits of the two years were £61,000, and his drawings amounted to £137,200. (*Incorporated Accountants.*)

28. Samuel Hobson, in business in the City, finds himself insolvent. From the various books and papers in his possession the following particulars as to his financial position are forthcoming. Prepare the Statement of Affairs for submission to his creditors and a Deficiency Account in the ordinary form.

Sundry Debtors (Good, £1,280; Doubtful, £2,800, estimated to produce £1,000; Bad, £700), £4,780; Sundry Freehold Houses, etc. (estimated to produce £2,000), £3,300; Shares: 1,000 Ordinary Shares in the Cable Telegraph Company, valued at par, £1,000; Mining and Railway Shares (2,500 are held as security by partly secured creditors and the balance by fully secured creditors), £9,450; Loss through the unsuccessful defence of an action at law, £5,420; Business Expenses, £3,200; Creditors: Unsecured, £16,740; Partly Secured, £5,420; Fully Secured, £3,110; Preferential claims for Salaries and Rent, £500; Private Drawings, £1,200; Samuel Hobson Capital Account, £3,800; Cash at Bank, £420; Bills Receivable, good, £800. (*London Chamber Commerce.*)

29. James Micawber became bankrupt. From the following particulars prepare his Statement of Affairs and Deficiency Account: Unsecured Creditors: Trade Debts, £8,500; Household Debts, £160. Trading Profits and Losses: First Year Profit, £2,000; Second Year, Loss, £1,000; Third Year, Loss, £600; Fourth Year, Profit, £300; Fifth Year, Loss, £2,300. Yearly Drawings, £800; Fully Secured Creditors (holding securities estimated to produce £10,000), £7,000; Liability on Bills Discounted (of which £100 is expected to rank), £1,060; Creditors for Rent, £150; Creditors for Rates, £30; Book Debts (Good, £1,100; Doubtful, £1,000, expected to produce £600; Bad, £180), £1,880; Bills Receivable, good, £650; Cash at Bank and in hand, £15; Stock (estimated to produce £1,750), £2,100; Capital at commencement of first year, £7,483; Household Furniture (estimated to produce £550), £700; Office Furniture (estimated to produce £100), £168. (*Central Association Accountants.*)

30. Prepare from the undermentioned particulars, as on December 31st, a Statement of Affairs, in the prescribed form, to present to a meeting of the creditors of S. Brook: Furniture and Fittings, £250, valued at £100; Cash at Bank (Current Account), £10; Cash in hand, £4; Sundry Debtors, £2,500 (Good, £1,000; Doubtful, £1,000, valued at £500; Bad, £500, valued at nil); Bills of Exchange, £300, valued at £100; Stock-in-trade, valued at £950, less 20 %; Household Furniture, valued at £850; Life Policy for £1,500 (surrender value, £550), held by the Bank as security for loan; 500 fully paid shares of £1 each, valued at par, in the Blankshire Biograph Company, Ltd., held as security by R. Brown; Trade Creditors, unsecured, £3,950; Loan from Bankers, £500 (secured as above); Loan from R. Brown, £600 (secured as above); Rent due, £150; Rates, £25; Wages (preferential), £10. (*Royal Society Arts.*)

31. A business carried on under the style of Wood and Smith finds itself in difficulties, and instructs you to prepare a Statement of Affairs for submission to a private meeting of the creditors.

The following particulars are obtained from the books, as at February 1st: Unsecured Creditors, £23,000 5s. 6d.; Loan from A £2,000; Creditors partly secured, £4,600 (estimated value of security, £4,000); Preferential Claims, £240 12s. 6d.; Stock-in-trade, £1,500 8s.; Cash at Bank, £270 14s. 2d.; Cash in hand, £65 4s. 10d.; Fixtures, £400; Debtors: Good, £820; Bad, £72 15s. 9d.; Doubtful, £41 5s.

As regards the separate estates, Wood had no creditors nor assets, and Smith was a limited partner with £1,000 in the business. With respect to

the loan A had lent the £2,000 without security and under an arrangement whereby he was to receive interest varying with the profits. (*Incorporated Accountants.*)

32 Henry Jones filed his petition in bankruptcy on June 30th. His books showed the following balances :—

	£	£
Cash in hand	10	
Fixtures and Fittings (estimated to produce £80)	250	
Stock-in-trade (estimated to produce £1,200) ..	1,800	
Sundry Creditors : Open Accounts		2,000
Sundry Creditors : Bills Payable		2,200
Sundry Debtors	5,000	
(Good, £1,000 ; Doubtful, £2,000, estimated at 50 % ; Bad, £2,000)		
Bank Overdraft		1,200
Capital		1,660
	£7,060	£7,060

Liability on bills discounted, £500, £100 expected to rank. His household furniture, etc., was valued at £250. He owned the house he lived in —it was valued at £750—and he had a mortgage on it of £600 at 4 %. Interest paid to December 31st previous. Preferential creditors amounted to £35 (included in Sundry Creditors), and £15 for rates on his house.

Prepare a Statement of Affairs. (*Chartered Accountants.*)

33. A finds, by the following summary of assets and liabilities of his business, that he is insolvent, and on October 15th files his own petition in bankruptcy. Prepare his Statement of Affairs for presentation to his creditors.

The Bank's overdraft is secured by the deposit of deeds representing his freehold property (valued for the purpose of the Statement at £6,000), and dock warrants for Stock of the value of £2,383 10s. 10d.

W. Smith's loan is secured by an assignment of a policy on A's life valued at £100.

There are contingent liabilities on bills discounted amounting to £589 17s. 2d., of which the sum of £229 13s. 5d. is expected to rank.

Of the Book Debts, A states that £144 are bad and £365 doubtful ; he estimates the value of the latter at £178.

Of the Bills Receivable, he estimates that the sum of £283 3s. 7d. is bad.

A has private debts, amounting to £389 5s. 3d., and has private assets consisting of the above-named policy and household furniture valued at £585

SUMMARY OF ASSETS AND LIABILITIES.

Liabilities.	£	s.	d.	Assets.	£	s.	d.
Sundry Creditors ..	23,598	7	6	Cash in hand	29	2	7
Bank Loan	6,897	3	6	Petty Cash in hand ..	2	13	9
W. Smith, Loan ..	589	2	6	Stock at cost	9,852	8	7
H. Jones, nine months' rent to September 29th ..	150	0	0	Fixtures and Fittings	329	7	2
Rates, six months' to March 31st	32	3	6	Office Furniture ..	262	8	0
				Horses and Carts ..	682	5	0
				Sundry Debtors ..	5,289	3	5
				Bills Receivable ..	4,283	3	7
				Freehold Property ..	6,589	2	7
	£31,266	17	0		£27,319	14	8

(*Chartered Accountants.*)

34. A trustee of a bankrupt estate, with liabilities of £18,000, has completed his realisation of the estate, and prepares to close the matter. His receipts have been: From Stock-in-trade, £1,250; Book Debts, £3,100; Jewellery Pledged, £700; Trading, £7,000; Household Furniture, £450; Freehold Buildings, £3,000. His payments have been: Costs of Petition, £40; Auctioneer's Costs, £180; Shorthand Writers' Charges, £15; Trading Payments, £6,250; Mortgage on Freehold, £2,000; Board of Trade Fees, £80; Notices in *Gazette*, etc., £5; To redeem Jewellery, £400.

The Committee allow the remuneration of the trustee at a commission of 5 % on assets realised and 3 % on assets distributed. Without providing for further payments, you are required to write up the Estate Cash Book, showing the final close of the estate. You must assume that all items have been received from or paid to Bank, but analysis columns may be dispensed with. (*Incorporated Accountants.*)

35. A receiving order was made against A. Boot, on June 25th. The following are the balances of his books at that date :—

	£	£
Unsecured Creditors		3,940
Capital Account, A. Boot		700
J. Smith, Loan Account		564
W. Jopp, Loan Account		12,654
Stock	4,113	
Fixtures and Fittings	250	
H. Finlay (Rent one year)		350
H. Jones, Manager (£150 per annum)		100
Collector, Rates and Taxes		85
Cash in hand and at Branches	110	
Horses, Carts, etc.	251	
Bill Receivable	169	
Sundry Debtors	2,446	
Cash at Bank	356	
Freehold and other Property	5,000	
Policy of Insurance (Surrender Value)	1,778	
Profit and Loss	776	
Drawing Account, A. Boot	1,219	
Interest on Loans	1,925	
Contingent Liability on Bills Discounted, £358 not expected to rank		
	£18,393	£18,393

On January 1st previous, there was a surplus of assets of £700. J. Smith holds a first charge on the policy of insurance. W. Jopp holds a second charge thereon, and also a charge on the Freehold and Leasehold Property. The Stock, for the purposes of the Statement, is valued at £3,500. Of the Book Debts, £291 are doubtful, and are estimated to produce £100; £287 are bad. The loss on trading between January 1st and June 25th was £776.

Make out the Statement of Affairs and the Deficiency Account in the forms required under the Act. (*Chartered Accountants.*)

36. A trader files his petition in bankruptcy on June 30, 19.., and you are instructed to prepare his Statement of Affairs. The information you are able to obtain as to his position is as follows :—

The Stock-in-trade at cost is £7,200, of which £600 worth is in the hands of a creditor for £1,000, who is entitled to exercise a lien; Book Debts: Good, £9,750; Doubtful, £120, worth 6s. 8d. in the £; Bad, £150; Fixtures and Fittings (after depreciation), £230; Cash in hand, £10; Bills

Receivable, £1,100 (held by Bankers against overdraft of £4,000, the balance of which is secured by a second charge on debtor's freehold property and by the guarantee of his brother); Customers' bills under discount, £1,500, of which £200 is ascertained to be bad, and £100 is doubtful; Freehold Property, £3,000, subject to a first mortgage of £2,000. The Unsecured Creditors amount to £29,000, in addition to claims for Rates, Taxes, and Wages amounting to £240. The Stock-in-trade and the Book Debts (outside the bills) are estimated to be worth 75 % of their face value, and the freehold property, which cost £2,800, is valued at £2,200. Subject to the modifications above stated, the assets are worth their book values.

You learn that the debtor had a surplus of assets of £5,000 on January 1, 19.., since when he has withdrawn £3,000 per annum in equal monthly instalments. His profits for year ended December 31, 19.., were £2,100, and for the next year, £420, since which time he has not made up his books.

From these details you are required to prepare as nearly as may be in statutory form:—(*a*) A Statement of Affairs; (*b*) a Deficiency Account. (*Incorporated Accountants.*)

37. From the following figures prepare Statement of Affairs and Deficiency Account as at December 31st. Assume that the Stock realises two-thirds of its value, the Fixtures one-half, the Shares par, and the Doubtful Debts one-third. On January 1st, two years ago, the debtor commenced business with a capital of £3,175. His profits for the first two years amounted to £2,027 10s. 6d., and his drawings were £1,500 a year.

Cash, £115 10s. 6d.; Stock-in-trade, £500; Debtors: Good, £3,500; Doubtful, £900; Bad, £750; Fixtures and Fittings, £282; Shares, £250; Creditors, unsecured (including £950 for wife), £6,950; Creditors, secured, £1,250; Value of securities held by creditors, £1,750; Preferential Claims for Rent, Rates, and Taxes, £95. (*Incorporated Accountants.*)

Chapter XIX

ASSURANCE ACCOUNTS

The term " Assurance " should be confined to the making of provision against events that are bound to happen, e.g. death ; the term " Insurance " to provision against events that may or may not happen, e.g. loss by fire. Technically, the first term is confined to Life Assurance and the second to contracts of indemnity entered into against loss from " perils of the sea " (Marine), Fire, Personal Accident, etc.

Definition.—A contract of life assurance is not a contract of indemnity. It is a contract, evidenced by a document, termed the *Policy*, whereby the *assurer* (the assuring company), in consideration of the payment of a *premium* by the *assured* (the person assured), agrees to pay a specified sum (with a share of the Company's profits, if the policy be a participating one) on the occurrence of a stated event in the life of the assured. The event may be (*a*) the reaching of a certain age, or (*b*) death ; and the premium may be (*a*) a sum down, termed a *single premium*, or (*b*) equivalent annual payments termed *annual premiums*, to be made during the life, or during a stated part of the life, of the assured. Annual premiums may by arrangement be paid half-yearly, quarterly, or even monthly, the company charging a slightly higher rate for the accommodation.

The policy is based upon a *Proposal Form*, issued by the company. This form contains a series of questions to be answered by the proposer. The utmost faith must be observed in answering these questions, and, in addition, the proposer is bound to disclose any material facts not brought out by the questions which the company ought to know in order to be able precisely to estimate the risk. Wilful errors in statements of fact, or the suppression of material facts, render a contract of life assurance liable to be declared void. Contracts of this kind are known as contracts *uberrimæ fidei*, i.e. of the utmost faith.

Classes of Life Assurance.—Life Assurance is divided into two broad classes, viz. (*a*) *Ordinary* ; (*b*) *Industrial.* In the first class, the premiums are paid either directly to the company or through the agent who effected the assurance on behalf of the assured, and the sum assured is rarely less than £50. In the second class, the premiums are collected weekly or monthly from the assured by house-to-house visitation, and the sum assured may be as low as £1.

Kinds of Offices.—Life offices are divided into two classes : (*a*) *Mutual* offices ; (*b*) *Proprietary*, or rather, *Mixed* offices. A mutual office is one wherein the participating policy holders themselves form

the proprietors, and the whole of the profit is divided amongst them. A mixed office is a Joint Stock Company, whose capital is subscribed in the ordinary way, the profits being divided between the shareholders and the participating policy holders in a ratio varying from 80 to 95 %, to the participating policy holders and the remainder to the shareholders.

Those offices which have combined for the purpose of fixing agreed uniform rates for various kinds of risk are termed *Tariff Offices*. Offices outside this combination are known as *Non-Tariff Offices*. But this distinction applies mainly to Fire and Employers' Liability Insurance, and not at all to Life Assurance, which is competitive.

Kinds of Insurance.—Almost any kind of risk can be insured against in these days. In addition to Life Assurance, the chief kinds of insurance are :—Marine, Fire, Personal Accident, Employers' Liability, and Bond Investment insurance. Other risks insured against are :—Sickness, Third Party Indemnity, Motor Car and Cycle, Burglary, Plate Glass, Forged Transfers, Cash and Jewellery and other valuables in course of transit, Hail, Storm, Lightning, Civil Commotion, War, including damage by hostile aircraft, etc.

Basis of Life Assurance.—Life Assurance is based upon two main principles :—(*a*) the Expectation of Life, more correctly termed the "Mean After-Lifetime" ; (*b*) the rate of interest that will probably be earned on funds invested at compound interest. The term "Expectation of Life" does not, as is sometimes erroneously supposed, signify the number of years that persons of a given age may reasonably expect still to live, for many lives will fall short of this period, and many will long survive it. It has no relation to the most probable after-lifetime of any particular person, but is computed over a large number of lives by taking the excess years of those who live long and distributing them amongst those who die early, thus placing all lives of the same age on an equality This function, the Mean After-Lifetime, is deduced from *Mortality Tables*.

A Mortality Table has been defined as "the instrument by means of which are measured the probabilities of life and the probabilities of death." There are two kinds of Mortality Tables : (*a*) those based upon Census Returns, and the deaths that have taken place during a definite period of time, and (*b*) those based upon the experience of assured lives, derived either from a single life office, or from a combination of Life Offices. The latest tables are the British Offices' Experience Tables (indicated by the symbol O), which were based upon the experience of 1,037,233 assured lives, contributed by sixty British Life Offices.

The data derived from the sources mentioned above are subjected by skilled persons, known as *Actuaries*, to the process termed Graduation, by which the fluctuations in the ungraduated mortality statistics, due to error, or disturbing influences, e.g. an inadequate number of observations, are eliminated, and the general rate of mortality is brought out.

The premium consists of (*a*) the *pure premium*, i.e. the annual sum which if paid by a sufficient number of persons of the same age, and accumulated at compound interest, say $3\frac{1}{2}\%$ per annum, will amount at death to their various sums assured, and (*b*) a *loading* to cover all the expenses of the office, and to provide a margin for a possible increase in the future rate of mortality, and for profits. The pure premium plus the loading make up the *office premium* charged by the company and paid by the assured.

Assuring companies limit the risk that they will assume on any one life by *re-assuring* with other companies that portion of the risk in excess of their maximum. The premiums paid for re-assurances are deducted from the item "Premiums Received" in the Revenue Account. A few companies confine their business to re-assurances.

Annuities.—Most assurance companies, in return for an immediate cash payment, undertake to pay an agreed sum yearly (half-yearly, or quarterly) during the lifetime of a specified person, termed the *Annuitant*. The purchase price is based on the age and sex of the Annuitant, less favourable rates being quoted in the case of female lives, owing to the greater longevity of women.

Insurable Interest.—In the great majority of cases, assurances are effected on the assured's own life. But one person may assure the life of another, provided that he has an *insurable interest*, i.e. a pecuniary interest, in the life of the other, only, however, to the extent that he has such an interest. Thus a creditor may, by way of collateral security, assure the life of his debtor to the extent of the debt; a wife may assure her husband's life in order to secure for herself a fixed sum should he pre-decease her; a partner may assure his co-partner's life in order to provide means to pay to the co-partner, or to his legal representatives, his share of the partnership assets on retirement or at death. By the provisions of the *Gambling Act*, 1774, a policy issued in the name of a person who has no insurable interest in the life assured may be declared void. Insurable interest is also necessary in the case of policies taken out to cover fire, marine, and other risks.

Lapsed Policies.—Thirty days' grace is allowed for the payment of assurance premiums, and failing payment within this extension the policy lapses and becomes void. But, whether the assured be alive or dead, the policy is capable of revival within twelve months, if five years' premiums have been paid, by payment of the outstanding premium plus a 10% per annum fine thereon. If less than five years' premiums have been paid, the lapsed policy may be revived on the same conditions, but subject to evidence that the assured is in good health.

Surrender Value.—Where an assured desires to surrender his policy before he has completed his contract, the assurance company will pay to the assured a sum termed the *Surrender Value* of the policy. This Surrender Value is based upon the Reserve Value of the policy. The Reserve Value consists of that portion of the annual premiums

not required to cover the risk for the year accumulated at compound interest. As a rule, a policy does not acquire a surrender value until three years' premiums have been paid (Endowment policies, two years), for the reason that the premiums paid during those early years are, for the greater part, absorbed by office expenses. Surrenders are usually made by the young and vigorous assured, and so exercise an injurious effect upon the assured as a whole by increasing the rate of mortality amongst the older and less vigorous who continue their policies for the full term of the contracts. The withdrawal of a number of first-class lives has precisely the same effect on the assured as a whole as would result from the addition of an equal number of inferior lives. For that reason, Life Offices, when computing the surrender value of a policy, make a sufficient deduction from the Reserve Value to counteract the effect of surrenders. Further, wherever that course can be followed, companies prefer to issue a paid-up policy based upon the Surrender Value, and so keep some part of the assurance in being; or they will apply the Surrender Value to the payment of future premiums, and keep the original policy in force until the Surrender Value is exhausted. The Surrender Value of a policy has no direct connection with the amount of the premiums paid, but, of course, it increases, and at an accelerated rate, with the payment of each premium. Most Life Offices guarantee on surrender a minimum proportion of the premiums paid, generally one-half for Endowment and one-third for Whole-Life Policies, with, in addition, any Reversionary Bonuses that may attach to the policy. The fact that policies acquire a surrender value gives them market value, and makes them available for loans.

Assignment.—A policy of life assurance may be assigned by one person to another either absolutely, or by way of mortgage. In both cases formal notice of the Assignment should be given to the company, and upon request, and payment of a fee of 5s., the company must acknowledge receipt of such notice. Companies do not, however, insist upon receiving the fee before acknowledging the receipt of notice. Notice enables the assignee to sue the company in his own name without joining the assignor as party to the suit.

Where a company receives notice of more than one assignment of the same policy, e.g. successive equitable mortgages, the priorities as between the assignees are determined, so far as the company is concerned, in order of the dates on which notice was received. But this does not necessarily affect the priorities of the assignees as between themselves, since these may sometimes be determined upon other grounds. Thus, where a person advances money on a policy, and he has had previous notice, actual or constructive, of a prior charge thereon, he cannot by giving notice thereby secure priority over the first incumbrancer, if the latter has omitted to give notice.

Absolute assignments made for "valuable consideration" should

be signed in the presence of a witness and be impressed with duty at the scheduled rate. An Ante-nuptial Settlement made for the benefit of a wife and children of the marriage, which may include a policy of life assurance, is made for valuable consideration.

Where the absolute assignment is voluntary, that is, not made for valuable consideration, but for "love and affection," as, e.g., in a Post-nuptial Settlement, the instrument must be stamped as if made for valuable consideration. But it is void as against the Trustee in Bankruptcy should the assignor become bankrupt within two years of making it, and it is void against the Trustee within ten years of making it, unless the parties claiming under the settlement can prove that the assignor was at the time of the assignment able to pay all his debts without the aid of the sum represented by the value of the policy, and that then his interest in the policy passed absolutely to the assignee (*Bankruptcy Act*, 1914, S. 42).

Assignments by way of mortgage, which may be either legal or equitable, are subject to the mortgagor's "equity of redemption." Only when the mortgagor has lost that right can the mortgagee exercise his power of sale, or surrender the policy to the company. But the mortgagee must account to the mortgagor for any surplus realised by sale or surrender, so long as the mortgagor has not lost his equity of redemption.

A legal mortgage is effected by deed and deposit of the policy. The deed must be stamped according to schedule.

Equitable mortgage of a policy is effected by deposit of the policy accompanied by a Memorandum of Charge, which is stamped at the rate of 1s. per cent. on the amount of the loan.

A person who takes assignment of a policy as security for a loan should insist upon deposit of the policy, since the fact that the policy was in the hands of a third party might affect him with notice of a prior incumbrancer to whom he would be postponed.

Claims.—The amount assured may become payable either by maturity of the policy or by death. A claim by maturity (Endowment Assurance), if made by the assured himself, is promptly paid on production of satisfactory evidence as to his age, identity, and title. Similar promptitude is observed if the assurance has been effected by a third person, e.g. a wife, provided she is alive at the date of maturity. Where the claim arises by reason of death, greater formality is observed. The company will then require a Registrar's Certificate of Death; a Declaration, made by some competent and disinterested person, as to the identity of the person described in the certificate with the life assured under the claimed policy; evidence of the date of birth; and the production either of Probate of his will, or Letters of Administration of his estate. It is always advisable to get the date of birth admitted on taking out the policy by producing a copy of the Birth Certificate, or failing that, other evidence of birth which the company

will accept, e.g. a Certificate of Baptism, an extract from an entry in a family Bible, or other family register.

Bonuses.—There are many kinds of policies issued by Life Offices. The most popular are *Endowment Policies.* Next in order are *Whole Life Policies*, the premium being paid (*a*) by a single sum down, or (*b*) by yearly premiums of equal amount, or (*c*) a limited number of premiums of larger amount, or (*d*) lower annual premiums during the first five years and higher annual premiums thereafter. Other policies issued are: Policies upon Joint Lives; Survivorship Policies; Short Period Policies; Children's Deferred Assurances; Sinking Fund Assurances, etc.

The broad line of demarcation between policies is that *with profits* and that *without profits*. The amount payable, when the claim arises, on a policy without profits is the amount of the sum assured; the amount payable on a policy with profits is the sum assured plus a share of the surplus of the company's assets over its liabilities as determined by each Quinquennial (or Annual) Valuation made by the company, and declared by the company as a *bonus* to its participating policy holders.

The sources of a surplus are mainly three: (*a*) where the loading added to the premium to cover expenses has proved to be greater than was necessary to defray them; (*b*) where the rate of mortality, owing to careful selection of risks, has proved lighter than that indicated by the Tables; (*c*) where a good interest return has been earned, owing to careful investment by the company of its funds, combined with a low rate of interest adopted for valuation.

There is more than one method of distributing a surplus amongst the participating policy holders, and more than one method of applying the bonus when declared. As to their application, bonuses may be taken in cash; or be added to the sum assured; or be applied to reduce future premiums, or to convert a Whole Term Policy into an Endowment Assurance payable at an advanced age, or, if the policy be an Endowment policy, to making it payable at a younger age.

Profits of Assurance Companies.—The profits of assurance companies cannot be ascertained by ordinary accounting methods; they must be determined by actuarial valuation. The *Assurance Companies Act*, 1909 (S. 5), regulates the frequency of actuarial valuations, which must take place "once in every five years, or at such shorter intervals as may be prescribed by the instrument constituting the company, or by its regulations or bye-laws." The majority of companies make a valuation once in every five years. This is known as the *Quinquennial Valuation*. But not a few companies make a yearly valuation, and some companies which distribute their bonuses quinquennially are in the habit, for their own private information, of valuing their assets and liabilities at the end of every year.

The objects of a valuation are: (*a*) to ascertain the company's net

liability in respect of all its policies and annuity contracts; (*b*) to determine the value of the amount of its Life and Annuity funds.

The method of valuation is to find (*a*) the present value of the sum of all the assurances and annuities to be paid by the company as they fall due, and (*b*) the present value of all the pure premiums to be paid by the assured as they fall due. The difference between these two is the Reserve, or sum of money that must be set aside, which, with the future pure premiums to be paid by the assured and accumulated at the rate of interest adopted for the valuation, will enable the company to pay all the claims as they arise.

Provision is made for future expenses and profits by valuing only the pure premium, i.e. by excluding that part of the office premium termed the loading.

The valuation of the liabilities is not made on the same basis as that adopted for the formation of the premium charged to the assured, but according to the most stringent mortality table and at the lowest rate of interest that will permit the payment of a fair rate of bonus to the assured. These premiums are termed *Valuation Premiums*, and their employment brings out a larger necessary Reserve than would be the case if the pure premium charged to the assured were employed. It is imperative that a Life Company's Reserve should be adequate to meet its liabilities and to provide for contingencies, hence the stringency of the valuation.

Against the Reserve required to discharge all its liabilities as they fall due, a company has its Life and Annuity Funds, being past premiums paid, accumulated at compound interest, less claims, management expenses, and profits paid prior to the valuation. These funds are invested in various ways—Mortgages; British Government Securities; Loans on Policies and other Reversionary Interests; Loans on Personal Security; Debentures; Stock Exchange Securities, etc. They must all be valued in the light of the facts and conditions prevailing at the time of valuation.

The difference between the amount required to be reserved by a company, and the amount of its Funds in Hand, as ascertained by valuation, represents its surplus or deficiency, as the case may be. If the surplus is large enough, a bonus is declared on the participating policies, and (if the company be a mixed one) a dividend to the shareholders. If the surplus is insufficient, both bonus and dividend may be passed, the amount being utilised to strengthen the company's Reserve. If an actual deficiency is disclosed, steps must be taken immediately to restore the financial position of the company.

Reference to the *Valuation Balance Sheet* on p. 731 will show that the company's total liability, i.e. the Reserve necessary to meet that liability, as disclosed by valuation, appears on the debit side of the statement, against which, on the credit side, appears the total of the Life and Annuity Funds, as set out in detail in the Third Schedule,

and also ascertained by valuation. The balance, if a surplus, is available for the appropriation of dividends to shareholders, bonuses to participating policy holders, transfers to Reserve, and the like.

Neither the accountants nor the auditors of a Life Company have any concern with the Quinquennial or other Valuation. That is solely actuarial work.

Assurance Accounts.—Assurance Companies are governed by the *Assurance Companies Act*, 1909, and are also subject to the *Companies Act*, 1929, so far as that Act applies. The schedules appended to the Act of 1909 display the forms of account obligatory upon insurance companies.

The Act embraces all persons, companies, or corporations transacting (*a*) Life, (*b*) Fire, (*c*) Accident, (*d*) Employers' Liability Insurance, and (*e*) Bond Investment Business.

Deposit.—Every company transacting life assurance must deposit with the Paymaster-General of the Supreme Court a permanent deposit of £20,000, and all companies registered after July 1, 1910, must deposit a further sum of £20,000 for each of the other kinds of insurance business conducted by them—(*a*) to (*e*) above. These regulations are modified by SS. 31 and 32 of the Act of 1909, as follows:—(1) Neither deposits nor separate funds are necessary in the case of Fire and Accident business if the company has made a deposit in respect of any other class of insurance. (2) In the case of Employers' Liability and Bond Investment business, when the separate funds have reached £40,000, the original deposit of £20,000 is refunded if deposits have been made in respect of any other class of business. Companies transacting Re-insurance business exclusively have been held liable to make the usual deposit.

Accounts.—Separate Revenue Accounts must be presented and separate funds be kept for each class of business transacted. Each separate fund is to be the security of the policy holders of that class, and is not to be applied except for their service. The Auditors must certify that this regulation has been complied with.

At the end of each financial year, the company must prepare (*a*) Revenue Account (First Schedule) for each particular class of business; (*b*) Profit and Loss Account (Second Schedule), except where the company carries on one class of business only; (*c*) Balance Sheet (Third Schedule). These accounts must be printed, and four copies must be deposited with the Board of Trade within six months of the close of the period to which they relate. These accounts are subject to audit under the provisions of the *Companies Act*, 1929, and Shareholders and policy holders are entitled to copies of them. The Fourth Schedule consists of the Valuation Balance Sheet dealt with above. The prescribed forms for the above accounts are shown on pp. 727–731.

It will be noted that the Statutory form of Balance Sheet enforces

SCHEDULES.

FIRST SCHEDULE.

N.B.—Where marine insurance business or sinking fund or capital redemption insurance business is carried on, the income and expenditure thereof to be stated in like manner in separate accounts. Any additional businesses (including employers' liability insurance business transacted out of the United Kingdom) to be shown in a separate inclusive General Account.

A.—Form Applicable to Life Assurance Business.

Revenue Account of the .... for the Year ending .... in respect of Life Assurance Business.

	Business within the United Kingdom.	Business out of the United Kingdom	Total.		Business within the United Kingdom.	Business out of the United Kingdom	Total.
	£ s. d.	£ s. d.	£ s. d.		£ s. d.	£ s. d.	£ s. d.
Amount of life assurance fund at the beginning of the year				Claims under policies paid and outstanding:—			
Premiums:—				By death			
Consideration for annuities granted				By maturity			
Interest, dividends, and rents .. .. £				Surrenders, including surrenders of bonus			
Less income tax thereon				Annuities			
				Bonuses in cash			
				Bonuses in reduction of premiums ..			
				Commission			
Other receipts (accounts to be specified)				Expenses of management			
				Other payments (accounts to be specified)			
				Amount of life assurance fund at the end of the year, as per Third Schedule			
£				£			

Note 1.—Companies having separate accounts for annuities to return the particulars of their annuity business in a separate statement.

Note 2.—Companies having both Ordinary and Industrial branches to return the particulars of the business in each department separately.

Note 3.—Items in this account to be net amounts after deduction of the amounts paid and received in respect of re-assurances of the Company's risks.

Note 4.—If any sum has been deducted from the expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above Account.

Note 5.—Particulars of the new life assurances effected during the year of account to be appended to the above account showing separately, as respects business within and business out of the United Kingdom, the number of policies, the total sums assured, the amount received by way of single premiums, and the amount of the yearly renewal premium income, the items to be net amounts after deduction of the amounts paid and received in respect of re-assurances of the company's risks. The particulars as to yearly renewal premium income need not be furnished in respect of Industrial business.

Note 6.—The columns headed "Business out of the United Kingdom," in the case of companies having their head office in the United Kingdom, apply only to business secured through Branch Offices or Agencies out of the United Kingdom.

B.—Form Applicable to Fire Insurance Business.

Revenue Account of the .... for the Year ending .... 19.. in respect of Fire Insurance Business.

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Amount of fire insurance fund at the beginning of the year:—							Claims under policies paid and outstanding						
Reserve for unexpired risks..							Commission						
Addition reserve (if any)							Expenses of management						
Premiums							Contributions to fire brigades						
Interest, dividends, and rents..							Other payments (accounts to be specified)						
Less income tax thereon							Amount of fire insurance fund at the end of the year as per Third Schedule:—						
Other receipts (accounts to be specified)							Reserve for unexpired risks being.. per cent. of premium income for the year						
							Additional reserve (if any)						
£							£						

Note 1.—Items in this account to be the net amounts after deduction of the amounts paid and received in respect of re-insurances of the Company's risks.
Note 2.—If any sum has been deducted *from the Expenses* of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above account.

C.—Form Applicable to Accident Insurance Business.

Revenue Account of the .... for the Year ending .... 19.. in respect of Accident Insurance Business.

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Amount of accident insurance fund at the beginning of the year:—							Payments under policies, including medical and legal expenses in connection therewith						
Reserve for unexpired risks..							Commission						
Total estimated liability in respect of outstanding claims							Expenses of management						
Additional reserve (if any)							Other payments (accounts to be specified)						
Premiums							Amount of accident insurance fund at the end of the year as per Third Schedule:—						
Interest, dividends, and rents							Reserve for unexpired risks being .... per cent. of premium income for the year						
Less income tax thereon							Total estimated liability in respect of outstanding claims as per Fourth Schedule (C)						
Other receipts (accounts to be specified)							*Additional reserve (if any)*						
£							£						

Note 1.—Items in this account to be the net amounts after deduction of the amounts paid and received in respect of re-insurances of the Company's risks.
Note 2.—If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above account.

D.—Form Applicable to Employers' Liability Insurance Business.

Revenue Account of the .... for the Year ending .... 19.. in respect of Employers' Liability Insurance Business transacted within the United Kingdom.

	£	s.	d.	£	s.	d.			£	s.	d.	£	s.	d.
Amount of employers' liability insurance fund at the beginning of the year:—								Payments under policies, including medical and legal expenses in connection therewith						
Reserve for unexpired risks								Commission						
Total estimated liability in respect of outstanding claims								Expenses of management						
Additional reserve (if any)								Other payments (accounts to be specified)						
Premiums								Amount of employers' liability insurance fund at the end of the year, as per Third Schedule:—						
Interest, dividends, and rents..								Reserved for unexpired risks, being ... per cent. of premium income for the year						
Less income tax thereon								Total estimated liability in respect of outstanding claims, as per Fourth Schedule (D).. ..						
Other receipts (accounts to be specified)								Additional reserve (if any)						
			£									£		

Note 1.—Items in this account to be the net amounts after deduction of the amounts paid and received in respect of re-insurances of the Company's risks.

Note 2.—If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above account.

E.—Form Applicable to Bond Investment Business.

Revenue Account of the .... for the Year ending .... 19.. in respect of Bond Investment and Endowment Certificate Business.

	£	s.	d.	£	s.	d.			£	s.	d.	£	s.	d.
Amount of Bond Investment and Endowment Certificate Fund at the beginning of the year								Claims under bonds and certificates, paid and outstanding ..						
Additional reserve (if any)								Commission						
Premiums								Expenses of management						
Interest, dividends, and rents								Other payments (accounts to be specified)						
Less income tax thereon								Amount of Bond Investment and Endowment Certificate Fund at the end of the year as per Third Schedule						
Other receipts (accounts to be specified)								Additional reserve (if any)						
			£									£		

Note 1.—Items in this account to be the net amounts after deduction of the amounts paid and received in respect of re-insurances of the Company's risks.

Note 2.—If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above account.

SECOND SCHEDULE.

Profit and Loss Account of the .... for the Year ending .... 19...

	£	s.	d.	£	s.	d.		£	s.	d.
Balance of last year's account							Dividends and bonuses to shareholders			
Interest and dividends not carried to other accounts.							Expenses not charged to other accounts			
Less income tax thereon							Loss realised (accounts to be specified)			
Profit realised (accounts to be specified)							Other payments (accounts to be specified)			
Other receipts (accounts to be specified)							Balance as per Third Schedule			
£							£			

THIRD SCHEDULE.

Balance Sheet of the .... on the .... 19.....

Liabilities	£	s.	d.	£	s.	d.	Assets.	£	s.	d.
Shareholders' Capital paid up (if any)							Mortgages on Property within the United Kingdom			
Life Assurance Funds *:—							Mortgages on Property out of the United Kingdom			
Ordinary Branch							Loans on Parochial and other Public Rates			
Industrial Branch							Loans on Life Interests			
Annuity Fund *							Loans on Reversions			
Fire Insurance Fund							Loans on Stocks and Shares			
Accident Insurance Fund							Loans on Company's Policies within their Surrender Values ..			
Employers' Liability Insurance Fund							Loans on Personal Security			
Bond Investment and Endowment Certificate Fund ..							Investments: Deposit with the High Court (Securities to be specified)			
Marine Insurance Fund							British Government Securities			
Sinking Fund and Capital Redemption Fund .. .							Municipal and County Securities, United Kingdom			
Profit and Loss Account							Indian and Colonial Government Securities			
Other Funds (if any) to be specified							Indian and Colonial Provincial Securities			
							Indian and Colonial Municipal Securities			
Claims admitted or intimated but not paid †:—	£	s.	d				Foreign Government Securities			
Life Assurance							Foreign Provincial Securities			
Fire Insurance							Foreign Municipal Securities			
Bond Investment							Railway and other Debentures and Debenture Stocks—Home and Foreign			

	£	s.	d.		£	s.	d.
Annuities due and unpaid †				Railway and other Preference and Guaranteed Stocks			
Other sums owing by the company † (to be stated separately under each class of business).				Railway Ordinary Stocks			
				Rent Charges			
				Freehold Ground Rents			
				Leasehold Ground Rents			
				House Property			
				Life Interests			
				Reversions			
				Agents' Balances			
				Outstanding Premiums †			
				Outstanding Interest, Dividends, and Rents †			
				Interest accrued but not payable †			
				Bills Receivable			
				Cash . On Deposit			
				In hand and on Current Account			
				Other Assets (to be specified)			
£				£			

NOTE 1.—When part of the assets of the company are specifically deposited, under local laws, in various places out of the United Kingdom, as security to holders of policies there issued, each such place and the amount compulsorily lodged therein must be specified in respect of each class of business, except that, in the case of fire, accident, or employers' liability insurance business, it shall be sufficient to state the fact that a part of the assets has been so deposited.

NOTE 2.—A Balance Sheet in the above form must be rendered in respect of each separate fund for which separate investments are made.

NOTE 3.—The Balance Sheet must state how the values of the Stock Exchange securities are arrived at, and a certificate must be appended, signed by the same persons as sign the Balance Sheet, to the effect that in their belief the assets set forth in the Balance Sheet are in the aggregate fully of the value stated therein, less any investment reserve fund taken into account. In the case of a company transacting life assurance business or bond investment business, this certificate is to be given on the occasions only when a statement respecting valuation under the Fourth Schedule is made.

NOTE 4.—In the case of a company required to keep separate funds under section 3 of this Act, a certificate must be appended, signed by the same persons as signed the Balance Sheet and by the auditor, to the effect that no part of any such fund has been applied, directly or indirectly, for any purpose other than the class of business to which it is applicable.

* Life companies having separate annuity fund to show amount thereof separately.

† These items are or have been included in the corresponding items in the First Schedule.

FOURTH SCHEDULE

VALUATION BALANCE SHEET OF .... AS AT .... 19...

DR. CR.

	£	s.	d.		£	s.	d.
To Net Liability under Life Assurance and Annuity Transactions (as per summary statement provided in Fourth Schedule [A])				By Life Assurance and Annuity Funds (as per Balance Sheet under Schedule 3)			
,, Surplus, if any				,, Deficiency, if any			
£				£			

publication of full details of the assets held. The power of an assurance company to meet its obligations is of paramount concern to the assured. Hence the object of the legislature is to ensure that full material for judgment shall be available.

The Revenue Account is a simple Income and Expenditure Account (with the sides reversed), the object of which is to show the growth or decline of the Funds in Hand available to meet the Company's liabilities. The Profit and Loss Account is necessary only where more than one class of business is transacted. It then takes the place of the Appropriation Account of commercial usage, combining the profits of the several departments, and showing the dividends and bonuses paid. If the Company is a limited company, the Balance Sheet (Schedule B) may be filed with the Registrar as "the statement in the form of a Balance Sheet."

The Accounts of British Assurance Companies are published annually by the Board of Trade and form a bulky Blue Book.

The student who desires to follow Assurance matters in more detail than is possible in this place is referred to the author's *Accounting*, pp. 792–837.

EXAMINATION QUESTIONS

1. What statute now regulates the accounts of Assurance Companies? Briefly describe the accounts which a Life Assurance Company is under obligation to publish. (*Royal Society Arts.*)

2. In connection with Insurance, what do you understand by the following: Mutual Companies; Tariff Companies; Surrender Value; Quinquennium? (*Chartered Accountants.*)

3. Explain the following class of policies in connection with Assurance: Endowment; Whole Life; Without Profits. (*Central Association Accountants.*)

4. What is meant by a "Quinquennial Valuation" in connection with life assurance accounts? Submit a *pro-forma* Valuation Balance Sheet showing the results of a quinquennial valuation. (*Royal Society Arts.*)

5. Give a *pro-forma* Valuation Balance Sheet of an Assurance Company. Contrast the methods of ascertaining profits employed by an Assurance Company with those of a commercial undertaking. (*London Chamber Commerce.*)

6. Under what heads should investments, other than Mortgages, of a Life Insurance Company be classified in the Balance Sheet so as to comply with the provisions of the Life Assurance Companies Acts? (*Chartered Accountants.*)

7. The following item appeared in the Balance Sheet of an Assurance Company: Loans on the Company's Policies within their Surrender Value, £45,986. Explain the meaning of this item, and describe the steps you would take to verify it as auditor to the Company. (*Chartered Accountants.*)

8. Briefly describe the form and scope of the annual accounts rendered obligatory on Assurance Companies by the Assurance Companies Act, 1909. Select *one only* of these accounts, and contrast it with an account of like nature prepared for similar purposes by a commercial company. (*Royal Society Arts.*)

9. Explain the meaning of the undermentioned items which appeared in the annual accounts of a Life Assurance Company, and state where they should appear in the published accounts of the Company: Life Assurance Fund at the beginning of the year, £4,099,971; Income Tax (less rebate) paid on interest, dividends, etc., £8,958; Claims, £198,487; Consideration for Annuities granted, £36,452; Deposit with the High Court, £20,440; Mortgages on Property within the United Kingdom, £409,489; Claims admitted but not paid, £66,431. (*Chartered Accountants.*)

10. Show the following amounts in the form prescribed in the First Schedule to the Assurance Companies Act, 1909:—

Amount of Fund at beginning of year, £1,410,000; Annuities payable, £14,800; Bonuses in cash, £2,700; Transfer and other fees, £150; Profit on Reversions, £5,010; Transfer from General Fund, £2,600; Interest and Dividends, £63,030; Claims, £51,500; Claims by Maturity, £28,100; Consideration for Annuities Granted, £9,060; New Premiums, £19,060; Renewal Premiums, £118,000; Surrenders, £8,700; Commission, £6,100; Expenses of Management, £15,010. (*Incorporated Secretaries.*)

11. Prepare Revenue Account and Balance Sheet, as on December 31, 1933, of the Popular Mutual Assurance Company, the following being the Ledger Balances: Assurance Fund, December 31, 1932, £739,100; Assignment Fees, £50; Annuities, £2,500; Agents' and other Debit Balances, £2,750; British Government Securities, £119,600; Consideration for Annuities granted, £6,200; Claims paid and outstanding, £51,800; Commission, £1,600; Claims admitted but not paid, £8,500; Cash at Bankers, £9,355; Cash in hand, £75; Deposit with the High Court, £20,000; Expenses of Management, £4,700; Foreign Government Securities, £33,800; Freehold Ground Rents, £46,900; House Property, £84,500; Interest, Dividends, and Rents, £29,400; Income Tax on Dividends and Rents, £6,650; Indian and Colonial Government Securities, £14,700; Interest accrued but not yet payable to the Company, £6,500; Loans on Reversions, £5,200; Loans on Policies, £53,100; Mortgages in the United Kingdom, £211,800; Outstanding Premiums, £8,420; Outstanding Interest, Dividends, and Rents, £700; Office Fixtures and Furniture, £1,200; Premiums, £52,600; Railway and other Debenture and Debenture Stocks, £137,200; Railway and other Preference Stocks and Shares, £12,000; Surrenders, £3,400; Sundry Creditors, £2,600. (*Chartered Accountants.*)

12. Make out in the form prescribed the accounts of the Samaritan Assurance Society from the following: Assurance Fund, January 1st, £260,042; Assurance Fund, December 31st, £258,999; Premiums, £18,195; Outstanding Premiums, £2,335; Loans on Society's Policies, £14,767; Consideration for Annuities granted, £850; Claims by death, £19,698; Commissions, £544; Expenses of Management, £2,344; Reductions allowed to members on their Premiums, £1,860; Interest, Dividends, and Rents, £9,050; Annuities, £1,173; Mortgages on Property, £70,369; British Government Securities, £57,634; Railway Shares, £112,746; Profit on Reversions fallen in, £2,156; Outstanding Interest and Rents, £1,081; Balances due by Agents, £66; Claims admitted but not paid, £4,177; Depreciation on Investments, £3,975; Surrenders, £1,700; Sundry Creditors, £836; Loans on Personal Security, £687; Accrued Interest, £2,269; Cash in hand, £2,058. (*Chartered Accountants.*)

13. Prepare a Revenue Account and Balance Sheet from the following list of balances in the books of a Life Assurance Company:—

Assurance Fund at the beginning of the year, £3,600,000; Annuities Paid, £12,500; Bonuses to Policy Holders, £15,000; British Government Securities, £190,000; Consideration for Annuities granted, £14,000; Claims Admitted,

but not paid, £14,500 ; Claims Paid, £280,000 ; Commission Paid, £27,000 ; Cash at Bank, £45,000 ; Expenses of Management, £37,000 ; Indian and Colonial Government Securities, £110,000 ; Interest and Rents received, £130,000 ; Loans on Company's Policies, £280,000 ; Leasehold Ground Rents (Investments), £6,000 ; Mortgages within the United Kingdom, £800,000 ; Mortgages on Rates, £1,200,000 ; Other Sums owing by the Company, £1,200 ; Outstanding Premiums and Agents' Balances, £56,000 ; Outstanding Interest (receivable), £57,000 ; Premiums, £460,000 ; Premises and Furniture, £26,000 ; Reserve Fund, £150,000 ; Rent Charges (Investments), £36,200 ; Railway and other Debentures, £1,150,000 ; Surrenders, £42,000. (*Chartered Accountants.*)

14. From the following Trial Balance prepare Balance Sheet and Revenue Account of the Life Assurance Society :—

Mortgages on Property within the United Kingdom, £400,000 ; Mortgages on Property out of the United Kingdom, £50,000 ; Loans on Life Interests, £100,000 ; Loans on Reversions, £200,000 ; Loans on Society's Policies within their Surrender Values, £600,000 ; Investments : Municipal Securities, United Kingdom, £500,000 ; Indian and Colonial Government Securities, £1,000,000 ; Freehold Ground Rents, £800,000 ; Reversions, £500,000 ; Outstanding Premiums, £50,000 ; Outstanding Interest, Dividends, and Rent, £10,000 ; Surrenders on Business within the United Kingdom, £20,000 ; Surrenders on Business outside the United Kingdom, £1,000 ; Cash in hand, £50,000 ; Claims admitted, but not paid (Cr.), £10,000 ; Claims on Business within the United Kingdom, £200,000 ; Claims on Business outside the United Kingdom, £10,000 ; Sundry Creditors, £15,000 ; Amount of Life Insurance Fund at beginning of year, £4,000,000 ; Expenses of Management, £20,000 ; Premiums on Business within the United Kingdom, £480,000 ; Premiums on Business outside the United Kingdom, £6,000.

NOTE.—£10,000 Indian and Colonial Government Securities have been deposited with the Government of the Cape of Good Hope in respect of Life Assurance business. (*Incorporated Accountants.*)

Chapter XX

BANK BOOK-KEEPING

[Note.—The subject of banking generally is treated in Chapter XXII, pp. 789-820. This chapter deals with the book-keeping system adopted by banks. No details can be given here of the various labour-saving machines now popular in banking circles. Principles only can be dealt with.]

The business of a banker is practically a cash business, and although it is not very complex, and subject to strict routine, yet the voluminous transactions, and the necessity for keeping the posting of the books abreast of the transactions, so that the bank may know how it stands as regards each customer individually, and its own position at the close of every day's business, make it imperative to employ special methods of posting. Unless the books are written up minute by minute, overdrawn accounts, with consequent bad debts, cannot be avoided. To meet this necessity for prompt entry of all transactions, banks have adopted the slip-system of posting. As the student is aware, this is not a system of book-keeping, but a method of rapidly posting books kept on double-entry principles. It is more fully employed by banks than by any other class of undertaking.

The current accounts of customers are kept posted continuously by means of slips, i.e. forms filled up either by the customers themselves, or by the bank officials. Eighty-nine per cent. of the payments into banks consist of cheques, bills, etc., and 11 % of notes, coin, etc.

When cheques and cash articles are paid in to credit by customers, they are, as everybody knows, detailed in paying-in slips, the form of which needs no illustration here. The receiving cashier enters this paying-in slip in his Cash Book, and, having done so, passes it on to the Waste Book keeper for analysis. The keeper of the Waste Book hands it to the Ledger keeper to be posted, and from him it passes to those responsible for writing up the Pass Books. In a similar way, the original cheques drawn on the bank by its customers are utilised as posting slips, and these furnish material for the debits in the current Account Ledgers and the Pass Books.

It will easily be seen from the above that the double-entry is effected with the minimum delay. The cashier paying a customer's cheque over the counter, enters the amount in his Cash Book. At the end of the day, all these payments are aggregated and posted through the General Cash Book to the credit of the Cash Account in the General Ledger.

This disposes of the credit entry. The cheques are handed, as they are paid, to the clerks who keep the current Account Ledgers, and are posted by them to the debit of the customers' current accounts, thus completing the double-entry. Subsequently the cheques are entered to the customers' debit in the Pass Books.

By utilising slips in this way, numerous ledger keepers can post the ledgers almost as quickly as the transactions occur. This would be impossible if the usual bound books of original entry were employed.

Transactions that are not covered by original documents are posted by means of dockets, i.e. by forms filled up by the bank's own staff. Such transactions may concern bills discounted, coupons collected, cheque books supplied, loans advanced, interest charged or allowed, etc. Two specimen dockets appear below :—

NATIONAL PROVINCIAL BANK LIMITED

PRINCES STREET, E.C.

June 28, 19..

DEBIT *George Dickson*, Current Account for transfer to Deposit Account

£100 : 0 : 0

L. C. C.
Accountant

This docket results from instructions received by the bank from George Dickson to transfer £100 from his Current Account to Deposit Account.

June 30th, 19..

Debit *John Smith*

£1 : 4 : 9

£100
to
date

For *Interest on Loan*

LLOYDS BANK LIMITED.

L. C. C.

This docket is made out by the bank staff in order to debit John Smith with interest on his loan to date.

It will be appreciated that the paying-in slips, paid cheques, and dockets are in effect loose journal entries from which the books are posted. A large proportion of a bank's staff is continuously employed in posting into current account ledgers and other books these loose journal entries. All the records made are interdependent and interlocking, and, in many cases, are arranged to pass through more than one pair of hands, as a safeguard against fraud.

A BANK'S BOOKS.

The items which compose a typical bank Balance Sheet are shown and explained on pp. 812–15. These items indicate the Accounting requirements of a bank, and the financial and other books that must be provided to meet those requirements.

Pass Books.—These are issued to all customers who keep current accounts with a bank, and also to customers who keep deposit accounts. They serve to record all transactions between a bank and its customers, and to show the state of the account as between banker and customer. The pass book is the property of the customer, but all the entries in it must be made by the bank.*

The precise legal effect of entries in a pass book has never been exactly determined. Entries in favour of a customer are *primâ-facie* evidence, but not conclusive evidence, against the banker. A banker may prove that an entry to a customer's credit is erroneous, and, if it is erroneous, the quicker he does so the better. But he cannot recover the amount wrongly credited, if the customer is able to show that in good faith and relying upon the accuracy of his pass book he was induced to alter his position, i.e. to spend money that otherwise he would not have spent. A business man would not, as a rule, find it easy to establish his good faith in taking advantage of a wrong entry to credit. But it would be otherwise with, e.g., an army officer on active service whose account was replenished by payments in made on his behalf by an army agent (*Skyring* v. *Greenwood*, (1825) ; *Holt* v. *Markham*, [1923]).

As regards entries against the customer, little more can be said than that, before a customer can be estopped from denying their accuracy, he must have been guilty of such negligence as to have caused the banker to alter his position detrimentally, or to have acted in such a way as to lead to the inference that he had treated the record in the pass book as a settled account. It is impossible to say, in the absence of any legal decision on the points, what conduct would constitute such negligence, or amount to an acknowledgment that the account was settled.

Prudence and sound business suggest that the banker should

* The introduction of mechanical book-keeping has now resulted in the "Pass-Book" being a loose-leaf binder for which the bank provides loose sheets recording the copies of the entries made in the customer's Account.

make up and send out the pass book at frequent and regular intervals, and the customer should carefully check the book, and immediately point out any inaccuracies, and this is the course followed.

Pass books are usually ruled in ordinary ledger form as follows :—

National Provincial Bank, Ltd.

IN ACCOUNT WITH W. BLACK.

19...		£	s.	d.	19...		£	s.	d.
Jan. 1	To Balance	342	10	0	Jan. 6	By J. Robinson	36	4	2
" 5	" War Loan Interest	31	5	0	" 8	" Self	20	0	0
" 8	" Cheques	94	0	0					

Payments in are recorded on the debit side ; withdrawals on the credit side, thus showing the position from the customer's point of view. It is the usual practice for auditors to apply *direct to the bank* for a certificate of the bank balance at the closing date of the accounts under audit. In most cases a Reconciliation Statement will be necessary in order to agree the amount certified with the Cash Book balance at the closing date.

The General Ledger.—This is the key ledger of a bank's accounting system. It contains adjustment accounts recording, in totals, the bank's assets, liabilities, profits, and losses, and their daily fluctuations. The ledger is self-balancing, and a Trial Balance extracted from it enables a Profit and Loss Account to be prepared expeditiously. Behind, and in support of, this ledger, there are numerous subsidiary ledgers and registers containing the detail of which the totals appearing in the General Ledger are composed. These ledgers " agree " with and explain their relative ledger accounts in the General Ledger. Totals only are entered in the General Ledger, and these represent the mass of detail arising out of the day's work, under each heading. Thus, for example, all cash paid in by customers during the day, appears in one total in Current Accounts of Customers' Account. At the close of each day, the detail balances of any single subsidiary ledger, or group of subsidiary ledgers, should agree with the relative account in the General Ledger. A list of accounts usually found in a bank's General Ledger, and a specimen account appear on p. 739.

On p. 740 is a specimen Trial Balance extracted from the General Ledger of a Bank. It is suggested that the student prepare from it a Profit and Loss Account and Balance Sheet in the form adopted by Banks.

Answer : Credit balance of P. and L. Account, £256,788 14s. 3d.; Balance Sheet totals, £21,142,612 11s. 5d.

GENERAL LEDGER ACCOUNTS.

Liabilities.		Assets.	
General Ledger Account.	Subsidiary Register or Ledger.	General Ledger Account.	Subsidiary Register or Ledger.
Share Capital.	Share Registers.	Cash	Cashiers' Money Books.
Reserve.		Bank of England.	Bank of England Books.
Current Accounts.	Current Account Ledgers.	Banking Correspondents.	Correspondents Ledger.
Deposit Accounts.	Deposit Account Ledgers.	Short Loans.	Short Loans Ledgers.
Bills Payable (or Acceptances for Customers).	Acceptance Registers and Diaries.	Investments.	Investments Ledgers.
Indorsements and Guarantees.	Registers and Diaries.	Bills Discounted.	Bill Registers and Diaries.
Branches.	Branches Ledgers.	Loans to Customers.	Customers' Loans Ledgers.
Interest. Commission. Sundry Profits. Profit and Loss Account. Rebate on Bills Discounted.	These accounts are sometimes kept in detail in the General Ledger and sometimes in a subsidiary Profit and Loss Ledger. *If* the latter ledger is kept, the relative General Ledger Account replaces the individual accounts of profit and loss.	Bank Premises.	Premises Ledger.
		Customers' Liability for Acceptances.	Acceptance Ledgers or Registers.
		Customers' Liability for Indorsements and Guarantees.	Indorsements and Guarantees Ledgers or Registers.
		General Expenses.	See Notes against Profit Accounts.

GENERAL LEDGER.

Current Accounts.

Date.	Dr.			Cr.			Balance Dr			Balance Cr.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
19... Dec. 31				180,402,611	17	6				180,402,611	17	6
19... Jan. 1	4,625,279	16	2	5,514,211	12	6				181,291,543	13	10
,, 2	5,257,162	14	8	6,039,212	14	8				182,073,593	13	10
,, 3	8,110,302	14	9	10,051,216	14	3				184,014,507	13	4
,, 3	184,014,507	13	4									
	£202,007,252	18	11	202,007,252	18	11						
19... Jan 3				184,014,507	13	4				184,014,507	13	4

Note.—The Current Accounts Ledgers Adjustment Account shown above has been closed and balanced as on January 3rd for purposes of illustration; in actual practice the accounts in the General Ledger are ruled off at periodical intervals, e.g. monthly or half-yearly.

The Loamshire Bank, Limited.

GENERAL LEDGER TRIAL BALANCE, DECEMBER 31, 19...

	Dr. £	s.	d.	Cr. £	s.	d.
Share Capital, 1,000,000 shares of £10 each, £1 paid				1,000,000	0	0
Reserve Fund, invested in 5 % War Loan				500,000	0	0
Current Accounts				15,122,111	14	9
Deposit Accounts				3,460,116	2	2
Acceptances for Customers				771,411	13	6
Indorsements and Guarantees				37,010	0	0
Cash	113,268	19	5			
Bank of England	1,006,049	13	2			
Foreign Correspondents	100,219	14	6			
Short Loans	3,241,028	9	2			
Investments	4,441,265	14	8			
Investments on account of Reserve Fund, 5 % War Loan, 1929/47, £555,555 11s. 1d. Stock at 90 ..	500,000	0	0			
Bills Discounted	3,114,122	19	3			
Loans and Advances to Customers ..	7,728,354	13	0			
Bank Premises	126,890	14	9			
Customers' liability for acceptances ..	771,411	13	6			
Indorsements and Guarantees per contra	37,010	0	0			
*Interest received				266,135	11	3
*Commission				22,126	19	8
*Discount				121,884	16	9
Profit and Loss Account, Balance brought forward				114,668	17	9
Interest paid	80,261	16	2			
General Expenses	91,212	14	9			
*Bad Debts written off	64,368	13	6			
	£21,415,465	15	10	£21,415,465	15	10

Note.—Reserve £32,184 6s. 9d. for rebate on bills discounted. The Profit and Loss Account balance is the balance left on that account after the payment of a dividend amounting to £100,000 on February 3, 19... It is not deemed desirable in the interests of the Bank to make public the totals of those Revenue Accounts marked *.

Day Book (Daily Summary) or General Cash Book.—This is a classified summary of the day's transactions, grouping together, on appropriate sides, the total entries for the day as they appear in the Cash Books, Journals, and other books of original entry. The General Ledger is posted from this book, a specimen of which appears on p. 741. Although frequently called a Cash Book, it will be noted that the book combines the functions of a Cash Book with those of a Journal.

Current Account Ledgers.—These are usually ruled as shown on p. 742 in cases where interest is allowed on current accounts, or as shown on p. 743 when no interest is allowed.

GENERAL CASH BOOK.

	Details. £	s.	d.	Folio.	Total. £	s.	d.
To Current Accounts, paid in ..					199,261	14	8
,, Branches					11,926	12	4
,, Bank of England, withdrawals					10,000	0	0
,, Bills Discounted, per Diaries					65,050	10	0
,, Customers' Loans paid off ..					1,000	0	0
,, Deposit Accounts, paid in ..					8,050	0	0
,, Short Loans recalled					25,000	0	0
,, Bills Payable, bills accepted ..					80,000	0	0
,, Acceptances, *acceptances due*					100,000	0	0
,, Cheque Stamps					1	15	0
,, Interest Received, on Discounts	605	14	8				
,, Interest Received, on Loans	102	9	3				
					708	3	11
,, Commissions					110	0	0
Total					501,108	15	11
Cash balance brought from previous day					35,014	12	2
				£	536,123	8	1

	Details. £	s.	d.	Folio	Total £	s.	d.
By Current Accounts, cheques paid					84,321	6	0
,, Branches, payments made ..					1,004	12	2
,, Bank of England, paid in ..					101,119	11	1
,, Customers' Loans made ..					500	0	0
,, Deposit Receipts, withdrawals					250	0	0
,, Short Loans made					150,000	0	0
,, Acceptances, bills accepted					80,000	0	0
,, Bills Payable, acceptances due					100,000	0	0
,, Interest Paid					4	7	1
,, General Expenses					113	2	2
Total					517,312	18	6
Cash Balance carried to succeeding day					18,810	9	7
				£	536,123	8	1

CURRENT ACCOUNT LEDGER (WITHOUT INTEREST COLUMNS).

CHARLES HAWKES, 1312 BROWNDEAN ROAD, W.C.

Date.		Details.		Dr.			Cr.			Balance.		
		Cheque No.	Payee.	£	s.	d.	£	s.	d.	£	s.	d.
19... Dec.	31	By Balance					111	14	6	111	14	6
19... Jan.	1	" Cash					24	2	6			
"	1	" Dividend on India Stock ..					0	15	0	136	12	0
"	1	To 12461	Bray	2	4	0						
"	1	" 12462	Wilding	11	6	0				123	2	0
"	2	" 12464	Self	5	0	0				118	2	0
"	3	" 12463	Commercial Union	1	2	2				116	19	10
"	4	By Cash					2	2	2	119	2	0
"	5	To 12465	Collieries, Ltd.	10	0	0				109	2	0
"	8	" 12466	Pepys & Co.	34	9	6				74	12	6
"	9	" 12467	Self	10	0	0				64	12	6
"	10	" 12468	Maitland	17	18	10				46	13	8
"	10	" Balance		46	13	8						
				£138	14	2	£138	14	2			
19... Jan.	10	By Balance					46	13	8	46	13	8

NOTE.—In the above example the account is shown as having been closed and balanced on January 10th; in practice it is usual to rule off the accounts and bring down the balances at half-yearly intervals only.

If, in the latter ruling, only one "Balance" column is provided, debit balances are entered in red ink and credits in black ink. In some banks all ledger accounts are written up in triple column form, as shown in the current account on p. 743.

Received (Counter) Cash Book.—Each receiving cashier is provided with a Cash Book ruled as under :—

RECEIVED (COUNTER) CASH BOOK.

Money.			Notes.	Name.	Total of Credit.		
£	s.	d.			£	s.	d.
160	10	6	£50 10/5 327628/37	Child Bros.	210	10	6
15	0	0		Moore & Co.	115	0	0

NOTE.—The first entry represents a payment in of £210 10s. 6d. (£160 10s. 6d. coin and £50 in notes). The second entry represents a payment in of £115 (£15 in coin and £100 in cheques); it will be noticed that the cheques received are included in the total column but are not stated separately in this book.

The coin is placed by the cashier in his till, and the notes and cheques are pinned to the paying-in slip and passed over to the Waste-Book clerk seated immediately behind him. This clerk enters the items in his "Received Day Book," analysed according to the manner in which they will be collected by the Bank. The ruling of a Received Day Book is shown on p. 745.

The notes are handed to special clerks to list and pay into the bank's account at the Bank of England, and the cheques are passed on to the clearing department for presentation at the London Bankers' Clearing House. Cheques on non-clearing banks go to the "Walks" department for collection by the "Walks" clerks. The paying slip itself is handed to the ledger keeper for posting.

The register recording transactions with the Bank of England is called the "Bank of England Book" or "Goldsmith's Book," a ruling of which is given on p. 745. Notes received by the Bank of England are not re-issued, but, after being cancelled, they are retained for seven years and then destroyed.

Deposits.—Banks accept cash on deposit at interest from customers, repayable at short notice, usually seven days, or at longer periods of notice as may be agreed between banker and customer. The interest allowed on deposits varies with the bank rate, and for deposits at short notice would be at the rate of 2 % below bank rate. Customers frequently transfer amounts from current to deposit account, in cases where their cash accumulates beyond their immediate needs. Such

RECEIVED DAY BOOK (Waste Book).

Name.	Total Amount			Details.																				
				Town Clearing.			Metropolitan Clearing.			Walks			Bank and Country Notes.			Bank of England.			House (own) and Country Cheques.			Money		
	£	s.	d	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s	d.	£	s	d
Child Bros.	210	10	6										50	0	0							160	10	6
Moore & Co. .. .	115	0	0	10	0	0	20	0	0	10	0	0				30	0	0	30	0	0	15	0	0

Note.—The entries given above correspond to those given in the Received Cash Book. The £100 in cheques paid in by Moore & Co. has been analysed according to the Bankers upon whom the cheques were drawn, viz. £10 Town Clearing, £20 Metropolitan, £10 Walks, £30 Bank of England cheques, and £30 country cheques.

In some forms of Waste Book the money and bank-notes entered on the paying-in slips are not recorded, the book being restricted in its use to the cheques paid in.

The Waste Book is by some regarded as the successor of the Goldsmith's Book used in the earlier days of banking.

BANK OF ENGLAND BOOK (Also called Goldsmith's Book).

Paid in.																		Withdrawn.				
Date.	Details.	Gold.			Notes.			Post Bills.			Bank of England Cheques.			Folio	Total.			Details.	Folio.	Total.		
		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.		£	s.	d.			£	s	d.
19... June 5	Receiving Cashiers				1,500	0	0	25	0	0	100	0	0		1,625	0	0	Notes		100	0	0
																		Gold		1,000	0	0
,, 5	Clearing							10	0	0	1,000	0	0		1,010	0	0	Silver		50	0	0
					1,500	0	0	35	0	0	1,100	0	0		2,635	0	0			1,150	0	0

transfers are made by dockets and are recorded in a separate Deposit Register, containing the same information as illustrated in the Deposits Diary given below. Deposit receipts are sometimes issued to customers. These are neither transferable nor negotiable. Usually, however, all transactions on deposit account are recorded in a Deposit Account Pass Book. Deposits received are recorded in the books of the bank's receiving cashiers, and dockets are made out and entered in the Deposits Diary ruled as follows :—

DEPOSITS DIARY.

Date.	Customer's Name.	Interest Rate.	Folio.	Amount.			Due Date.	Repaid Date.
				£	s.	d.		

When deposits are repaid, they are passed through the paying cashier's books, and the Deposits Paid Register. If deposits are retransferred to Current Account, dockets are made out and entered in the Deposits Register, and the Customers' Deposit Accounts are debited and their Current Account credited. All deposits are posted to the Deposits Ledger, ruled in parallel columns to record the deposits, withdrawals, balances, number of days, interest, etc.

Paying Cashier's Counter Cash Books.—Each paying cashier is provided with a Cash Book ruled as under :—

PAYING CASHIER'S COUNTER CASH BOOK.

(Supplementary Paid Cash Book.)

Total.			Name.	Numbers of Bank-notes.	Amount of Notes.			Money.		
£	s.	d.			£	s.	d.	£	s.	d.
35	0	0	C. Wrayson	22621/3 3/5	15	0	0	20	0	0
5	0	0	W. Higgins					5	0	0
10	0	0	C. Meyer	13298 1/10	10	0	0			

Before paying a cheque, the cashier scrutinises the signature or signatures to the cheque, and the indorsements, if any, and satisfies himself that they purport to be correct and in order. If he is in doubt as to the genuineness of the customer's signature, he compares it with the specimen signature of the customer in the bank's signature book ; and if there is any doubt as to the customer's balance being sufficient to meet the cheque, he refers to the customer's current account in the

ledger. All paid cheques are entered at the time of paying in the Paid Cash Book, illustrated as under :—

PAID CASH BOOK.

Name.	Waste Book.			Walks.			Paid Cashiers.		
	£	s.	d.	£	s	d.	£	s.	d.
C. Wrayson							35	0	0
W. Higgins							5	0	0
C. Meyer							10	0	0

The totals of the Paid Cash Book are entered, at the close of the day's business, on the credit side of the General Cash Book, and are from there posted to the General Ledger.

Bills of Exchange.—These occasion a very large but diminishing proportion of the book-keeping work of a bank. The cheque is the most popular instrument of payment, but the bill payable after sight or date plays a very important part in the settlement both of home and international indebtedness. The wholesale dealer requires cash; the retailer wants credit, and both requirements are satisfied by the creditor drawing, the debtor accepting, and the banker discounting a bill of exchange payable on a future date. Bills of exchange received

BILL DIARY.

Ledger Folio.	Acceptor.	Folio.	For Whose Credit at Maturity.			
				£	s.	d.
	Clutterbuck Bros., Ltd. ..		Miles & Co...	500	0	0
	Butterworth & Sons, Ltd.		A. Brown	1,000	0	0
	Measonthwaite & Co. ..		C. Day..	250	0	0
	A Child Co.		B. Wray	10	0	0
				£1,760	0	0

NOTE.—The total (£1,760) is entered in the Cash Book for the day as a debit, and the various customers are credited either direct from the diary or from credit slips made out to correspond with the entries it contains.

by a banker for collection are termed *short bills*, or *bills for collection.* In foreign exchange transactions, any bill with not more than ten days to run before it reaches maturity is a short bill. Bills with unexpired currencies for periods up to six months are termed long bills.

A banker who discounts a bill is holder of the bill for value. The customer must indorse the bill in blank before the banker will discount it, and then it becomes the banker's property. Discounted bills are kept apart from bills paid in for collection, and treated separately in the banker's books.

BILL LEDGER.

CHARLES MARSHALL & CO.

Date.	When Due.	Amount. £	s.	d.	Acceptor.	Dr. £	s.	d.	Cr. £	s.	d.	Balance. £	s.	d.
19... April 1	April 20	100	0	0	Child & Co.									
	May 31	150	0	0	Brown & Co									
	June 26	80	0	0	Robinson & Co.				330	0	0	330	0	0

NOTE.—As the Bills are paid they will be debited in this ledger from the Bill Diary, and the amount in the Balance column will be adjusted accordingly.

BILLS DISCOUNTED REGISTER.

(DISCOUNT REGISTER.)

No.	Date	Name.	Drawer	Payee.	Acceptor	Date of Bill.	Tenor.	When Due.	Amount. £	s.	d.	Total. £	s.	d.	Discount. Days to Run	Discount. Rate.	Discount. Dis-count.	Discount. Total of Discount £	s.	d.	Remarks.
3250	19... June 1	W. Brown	Smith	A. King	National Bank of S. Africa, London	May 10, 19 .	3 months	Aug. 13				150	0	0	73	4 %		1	4	0	Paid
3251	June 1	Roberts Bros	Selves	Selves	Hosier & Co.	Mar. 12, 19 .	3 months	Aug 15	500	0	0				75						Paid
3252	June 1	Roberts Bros.	Selves	Selves	C. Ray	May 14, 19 .	3 months	Aug. 17	200	0	0	700	0	0	77			5	15	10	Rebated

Short bills handed in for collection are attached to special paying-in slips and are handed to the bill office for record and collection. A small commission is charged for clearing Scotch and Irish bills. The bills are entered in specially ruled diaries according to their due dates. The maturities of each day are presented for payment. The receiving cashiers' books are debited with the total bills due for collection, and the customers' current accounts are credited. A form of Bill Diary is given on p. 747.

A suitably ruled Bill Ledger, with an account for each customer, is also kept, the ruling of which is shown on p. 748.

The outstanding balances in the Bill Ledger should agree, at any time, with the like information extracted from the Bill Diaries.

When bills are purchased (discounted), the bank records them in a Bills Discounted Register, a ruling of which appears on p. 748. They are also entered in a Bills Discounted Diary similar in form to that already given on p. 747. In order to keep a check upon the bills purchased from any one customer, a memorandum Discount Ledger is also kept. The "maximum" limit of accommodation fixed (if any) is recorded at the head of the customer's account.

When bills are discounted, posting slips are prepared crediting the customer with the face value of the bill, and debiting him with the discount charged, through the General Cash Book, and the General Ledger, "Bills Discounted Account" is debited with the daily total of the bills purchased, and Discount Account is credited with the total discount charged. When the bills mature, the cash books are debited, and Bills Discounted Account is credited with the total of the bills due each day as explained in the case of short bills. The provision for rebate on bills not due is explained on p. 815.

Acceptances.—As explained on p. 815, banks undertake to accept bills on behalf of customers who are required to satisfy foreign exporters

ACCEPTANCE LEDGER.

BANK OF IDAHO.

Date Accepted	Date Due	Number		Dr			Cr.			Balance.		
		Of Credit.	Of Bill.	£	s.	d.	£	s.	d.	£	s.	d.
19...												
Mar. 1	June 4	3256	1421	200	0	0				200	0	0
	June 4	Due	Due				200	0	0			

that the bills drawn upon them by those exporters will be duly paid. Customers so accommodated are charged a commission. Bills so accepted are entered in an Advice Book and an Acceptances Register

SECURITIES RECEIVED REGISTER.

Date Received.	Received for Account of	Amount of Security.	Description.	Securities Ledger Folio.	Received from
19...		£			
June 10	A. Kaye	1,000	Belgian 3 % Loan, 1914	1442	Hirst Bros.
June 12	A. Kaye	100	Budapest 4½ % Loan 1914 Scrip ..	1442	Hirst Bros.

NOTE.—The Securities Delivered Register is ruled in similar manner, the headings being altered to correspond.

LOANS LEDGER

CHARLES MELVILLE, 1888 UPPER JAMES'S STREET, S.W.

Date.	Dr. Loan Made.			Cr. Loan Repaid.			Balance.			Interest.						Particulars of Security Held.	Value of Security.			Disposition of Security and Remarks.
										Days.	Product.	Rate.								
	£	s.	d.	£	s.	d.	£	s.	d.				£	s.	d.		£	s.	d.	
19... Jan. 1	1,000	0	0				1,000	0	0	56	56,000	5	7	13	5	£1,000 Japanese Government 4½ % 1st series	1,010	0	0	Transferred to securities held for safe custody on repayment of loan.
Feb. 26				1 000	0	0										£500 Brazil 5 % Fdg.	430	0	0	

containing full details of each acceptance. Acceptance Diaries are also kept, similar in form to the Bill Diary already described and illustrated. A memorandum Acceptance Ledger is also kept containing an account for each customer for whom bills have been accepted. The customer is debited with the bank's acceptances on his behalf, and credited as and when he pays the bills. These accounts therefore show at any time the acceptances outstanding on behalf of customers individually and collectively. The ruling of an Acceptance Ledger is given on p. 749.

Securities.—Customers frequently deposit securities and other valuables with their bankers for safe custody ; and, in the case of bearer securities, request the banker to detach the interest coupons as they fall due, and collect them on their behalf, and also to notify them should any of the bonds be advertised as having been drawn for redemption. As a rule, bankers perform this service for their customers gratuitously. A banker has no lien on securities or other valuables deposited for safe custody, unless a lien be specially created. But where the banker detaches and collects coupons attached to securities, it would appear that he has a constructive lien on the securities to the extent of any moneys due to him, or that may become due to him, from the customer for whom he so acts, so long as they are in his custody.

Securities thus held for safe custody are recorded in a Securities Received Register, as illustrated on p. 750.

A memorandum Securities Ledger is also kept containing an account for each customer who deposits securities, in which a full description of the securities lodged and withdrawn is recorded.

Where the securities or other valuables lodged for safe custody are contained in locked boxes, the banker takes no cognisance of the contents of the boxes.

Loans to Customers.—Loans made to customers, and the interest accruing thereon, are posted by means of dockets, as already illustrated, and details are recorded in the Loans Ledger, in which an account for each borrower is kept, recording full details of loans made and the security deposited as cover. The ruling of a Loans Ledger is given on p. 750.

Where overdrafts are allowed on current accounts, the maximum credit allowed is recorded at the head of the customers' ledger account.

Banks do not advance loans for indefinite periods. A Loans Diary is therefore kept recording the fixed due dates of all loans.

EXAMINATION QUESTIONS.

1. A banking institution has accepted bills drawn upon them on behalf of customers, payment to be provided for by the latter on or before maturity ; state how the respective responsibilities of the Bank and of its customers should be stated in the Balance Sheet of the Bank. (*Chartered Accountants.*)

2. On November 15th the Loamshire Bank Ltd., purchased a two

months' bill for £100, dated October 30th, drawn by William Archer and accepted by George Shaw. State the entries which the Bank would make when recording this transaction, and give the ruling of one of the books named by you as employed by the Bank. (*Royal Society Arts.*)

3. Explain briefly the methods employed in order to keep the books of a Bank constantly posted.

On July 31st, George Reimers paid in the following to his Bank in the City: Cheque (Geo. Smith, London), £15; Cheque (Robt. Robinson, London), £20; Gold, £10; Bank of England Notes, £20.

Describe the passage of the above items through the books of the Bank from the moment of their receipt until credited to the account of George Reimers. (*Royal Society of Arts.*)

4. R. Craven opens a bank account on January 1st with the Rosedale Banking Company, and deposits on that date £1,000. He pays in as follows: January 20th, £500; March 20th, £600; May 20th, £700; and he draws out on February 20th £1,200, on April 20th £1,000, and on June 20th £500. Calculate the Bank Interest, counting 5 % on customer's debit balances and 2 % on credit balances, and close the account on June 30th. (*Incorporated Accountants.*)

5. Define the term "Bank Rate," and show how the level of Bank Rate affects that of other interest rates. (*Chartered Accountants.*)

6. Indicate the principal sources of profit accruing to a joint-stock bank carrying on business in England and Wales. (*Chartered Accountants.*)

7. Give two alternative rulings suitable for the Current Accounts Ledger of a Bank. From what materials are these ledgers written up? (*Royal Society Arts.*)

8. On January 25th, John Smith called at the Union Bank of London and paid in the following:—

	£
Gold	25
Bank of England Notes	50
Cheque drawn on the Old Bank, York	62
Cheque drawn on the Joint Stock Bank, Princes Street, E.C. ..	41
	£178

Trace the history of the above items as they would appear in the books of the Union Bank of London. (*Royal Society Arts.*)

9. I paid into my Current Account with the National and Provincial Bank, Ltd., on October 19th, the following:—

	£	s.	d.
Gold Coin	5	0	0
Silver and Copper Coin	0	15	9
Bank of England Notes	10	0	0
Cheque on the Bank of England	15	12	6
Town Cheques on various Banks	39	14	2
Cheque on the National and Provincial Bank, Ltd... ..	16	2	4
	£87	4	9

Rule the following forms and enter therein the foregoing items as far as the various forms are concerned: (1) Paying-in Slips; (2) Receiving Cashier's Counter Cash Book; (3) Received Waste Book; (4) Bank of England Book. (*London Chamber Commerce.*)

10. I drew a cheque on my Current Account for £55, which I presented for payment across the counter, taking £5 in gold, £5 in silver, and the remainder in £5 Bank of England notes.

Rule a form of Paying Cashier's Counter Cash Book, and enter in it the foregoing transactions. (*Royal Society Arts.*)

11. Give a ruling suitable for use in the Current Accounts Ledger of a Bank. Enter six specimen transactions therein; and explain the advantages of the form you advocate. (*London Chamber Commerce.*)

12. Describe the principal books of account (not more than six) used in Banking. (*Chartered Accountants.*)

13. Explain the meaning of the following items extracted from the Balance Sheet of a Bank: (*a*) Rebate on Bills not due (liability side); (*b*) Money on short notice (assets side); (*c*) Liabilities of customers on acceptances as per contra (assets side); (*d*) Liabilities by indorsement on foreign bills sold (liabilities side). (*Chartered Institute Secretaries.*)

14. Describe the ordinary routine of discounting a bill of exchange, the entries to be made in the bank's books, and the nature of the enquiries necessary. (*Chartered Secretaries.*)

15. After writing up the Profit and Loss Account, the General Ledger balances of the Conservative Bank, Ltd., as on December 31st, were as follows: Paid-up Capital, £1,500,000; Cash at Bank of England and in hand, £2,600,980; Customers' Current and Deposit Accounts, £17,580,000; Bills Discounted, Loans and Advances, £14,482,000; Freehold Premises, £380,000; Rebate on Bills Discounted, not yet due, carried to next account, £24,300; Reserve Fund, £1,200,000; English Government Securities, £1,250,000; Other Government Securities, £520,000; Profit and Loss Account (undistributed balance), £110,680; Securities pledged with public bodies, £81,000; Indian and Colonial Securities, £1,101,000. On the same date (December 31st) the acceptances on behalf of customers, and for which they were liable, appeared in the Acceptances Book of the Bank at £1,725,420. Prepare a Balance Sheet as on December 31st. (*London Chamber Commerce.*)

16. From the following figures prepare the Profit and Loss Account and Balance Sheet of the B. C. Banking Company, Ltd., at December 31st: Capital, £2,000,000; Reserve Fund, £1,000,000; Cash at Head Office, Branches and Bank of England, £4,685,459 14s. 1d.; Loans at Call, £2,920,183 14s. 8d.; Interest paid to Customers, £67,599 11s. 7d.; Profit and Loss Account Balance, June 30, 1916, £61,685 12s.; Investments: Consols, £6,950,248 17s. 1d.; Colonial Stock, £950,127 3s. 9d.; Corporation Stock, £1,209,246 18s.; Other Securities, £12,732 11s. 5d.; Salaries and Expenses, £217,196 11s. 6d.; Current and Deposit Accounts, £34,450,116 7s. 10d.; Liabilities on Acceptances, £3,234,502 18s. 6d.; Discounted Bills Current, £10,140,079 14s. 4d.; Advances to Customers, £10,434,135 12s. 4d.; Rebates on Bills not due carried to next Account (debit Profit and Loss Account), £27,207 6s. 2d.; Liabilities of Customers for drafts accepted by the Bank (as per contra), £3,234,502 18s. 6d.; Freehold Premises, Fixtures, and Fittings, £488,127 5s. 2d.; Amount now written off Premises Account, £20,000; Gross Profit for Half-year, £553,335 14s. 1d. (*Incorporated Accountants.*)

17. From the following particulars prepare the Profit and Loss Account for the half-year ended December 31st and Balance Sheet at that date of the Security Banking Company, Ltd. Before doing so transfer £50,000 to Reserve Account and write off £30,000 from Premises Account; bring into account Rebate on Bills Discounted, £40,600, and Acceptances on Account of Customers, £1,560,000.

Investments in British Government Securities, £6,530,220 ; Advances to Customers, £20,840,450 ; Current and Deposit Accounts, £50,308,730 ; Cash in hand and at Bank of England, £7,560,680 ; Salaries and all Expenses, including Auditors' and Directors' Fees, £300,880 ; Profit and Loss Account, Cr. Balance at July 1st, £90,890 ; Bank Premises, £630,000 ; Investment in India Government Securities, Guaranteed Stock and Debentures, £3,566,840 ; Loans at Call and Short Notice, £3,740,530 ; Reserve Fund, £2,500,000 ; Investment in Metropolitan and other Corporation Stocks, £1,876,540 ; Discounted Bills, £8,940,570 ; Interest Paid to Customers, £160,830 ; Capital Subscribed, £4,000,000—Paid up, £1,000,000 ; Gross Profit, £548,420 ; Investments in "Other Securities," £300,500. (*Central Association Accountants.*)

18. Draw up a rough Balance Sheet of an English joint-stock bank (other than the Bank of England) and explain the significance of the items included in it. (*Chartered Secretaries.*)

Chapter XXI

BILLS OF EXCHANGE. CHEQUES. PROMISSORY NOTES

[NOTES.—For a complete exposition of this subject and banking generally, the student should consult H P. Sheldon's *Practice and Law of Banking* (price 12s. 6d.), a text-book recommended by the Council of the Institute of Bankers. On Commercial Law, the student is directed to H. W. Disney's *Elements of Commercial Law* (price 3s. 6d.).

The references throughout this section are to the *Bills of Exchange Act*, 1882, unless otherwise stated.]

THE law governing Bills of Exchange, Cheques, and Promissory Notes is contained in the following Statutes: The *Bills of Exchange Act*, 1882; the *Bills of Exchange (Crossed Cheques) Act*, 1917; and the *Bills of Exchange (Time of Noting) Act*, 1917. The rules in bankruptcy relating to these instruments continue to apply thereto, notwithstanding anything contained in these Acts, and so also do the rules of common law* and the law merchant,† in so far as they are not inconsistent with any of the express provisions of the Acts.

Bills of Exchange, Cheques, and Promissory Notes belong to that limited but highly important class of commercial documents known as *Negotiable Instruments*. A negotiable instrument is a document containing a contract to the ownership of which document are attached all rights under the contract. The *bona-fide* possessor of such a document is presumed to be the lawful owner of it. The document with all the rights conferred by it can be transferred by one person to another, sometimes by mere delivery, sometimes by delivery accompanied by indorsement of the document, and the person to whom it is transferred, provided that he takes it in good faith, takes it free from any rights that could be enforced against the transferor, and free from any defect in the transferor's title to the document. It will be seen that negotiable instruments are an exception to the general rule of law that one party to a contract cannot assign his rights under the

* The Common Law is that great body of law which has never been formally enacted by any legislative power, but is founded upon tradition and the immemorial and general custom of the realm, as interpreted by the judges. Since it does not originate in any formal enactment it is often called "the unwritten law." Statute Law consists of Acts of Parliament, and is often called "the written law," in contradistinction from the Common Law (Disney, *Elements of Commercial Law*, p. 1).

† The Law Merchant resembles the Common Law in being unwritten, but it depends on commercial usage, which, having become universal, is recognised by the Courts as binding, but which may be of modern origin (Disney, *op. cit.*, p. 1).

contract to a third party, except subject to any existing rights which the other party to the contract may have against him.

Examples of negotiable instruments are: Bank Notes, Bills of Exchange, Cheques, Promissory Notes, Dividend Warrants, Exchequer Bonds, Debentures payable to bearer. A Bill of Lading has some of the qualities of a negotiable instrument, but it is not a fully negotiable instrument, because no one who takes a bill of lading can acquire a better title to the goods represented by it than has the person who transfers it.

I. Bills of Exchange.

Uses of the Bill of Exchange.

(*a*) It affords a cheap and safe means of remittance, avoiding the transfer of actual cash. Since a bill of exchange may be freely negotiated, the same bill may effect many transfers of funds, and so settle many debts, before it is finally discharged.

(*b*) It is a great instrument of credit, enabling the seller of goods to give credit to the buyer, and at the same time obtain ready cash for himself. For example: A manufacturer sells to a merchant £100 worth of goods, one of the conditions of sale being that the buyer shall accept the seller's bill of exchange payable three months after date for the price of the goods. The seller draws, and the buyer accepts, the bill. The seller then indorses the bill in blank, takes it to his banker, who discounts the bill. That is, the banker immediately credits his customer's account with the amount of the bill, less the charge for discounting. If discount rate were 6 % p. a., the amount credited would be £100 less $\frac{1}{4}$ of £6 = £98 10s. If the bill be duly paid at maturity, the banker retains the £100; if it be not paid, he returns the bill to the customer and debits him with £100, plus any expenses incurred. Alternatively, where the circumstances warrant such a step, the banker retains the bill, and sues as holder for value, the parties to the bill.

(*c*) An accepted bill of exchange is better evidence of debt than an ordinary open book debt. In the first place, a bill fixes the date of payment. Secondly, if a debtor is sued for recovery of an open book debt, he may defend the action on any ground available to him. But if he has accepted a bill of exchange for the amount, then, provided he has received due consideration for his acceptance, he has no defence if he dishonours the bill. The drawer may apply for summary jurisdiction, since the damages upon dishonour are liquidated damages (*see* p. 770).

Legal Definition of Bill of Exchange.—A bill of exchange is an unconditional order in writing, addressed by one person to another signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person or to

bearer (S. 3 [1]). An instrument that does not comply with these conditions, or which orders any act to be done in addition to the payment of money, is not a bill of exchange (S. 3 [2]).

The points to note about the above definition are that to be a bill of exchange the instrument must be :—

(*a*) " An order." Not a prayer or entreaty but a command.

(*b*) " Unconditional." An order to pay out of a particular fund is not unconditional, but an unqualified order to pay, coupled with an indication of a particular fund out of which the drawee is to re-imburse himself, or a particular account to be debited with the amount ; or a statement of the transaction which gives rise to the bill, is unconditional (S. 1 [3]).

(*c*) " In writing." Writing includes print and typewriting.

(*d*) " Addressed by one person to another." The word " person " includes a body of persons whether incorporated or not (S. 2). The person addressing the order is called the *drawer* ; the person to whom the order is addressed is termed *the drawee*. The drawee must be named or otherwise indicated in a bill with reasonable certainty. A bill may be addressed to two or more drawees whether they are partners or not, but an order addressed to two drawees in the alternative, or to two or more drawees in succession is not a bill of exchange (S. 6).

(*e*) " Signed by the person giving it." It is not necessary that the drawer should append his signature to the order at the time of making it. He may do so subsequently after acceptance, but until he does, the instrument is inchoate, i.e. incomplete. The drawer need not sign the order by his own hand ; he may do so by his agent duly appointed for the purpose.

(*f*) " Requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time." A bill is payable on demand, when it is expressed to be so payable, or expressed to be payable " at sight," or " on presentation," or when no time for payment is expressed, or when a bill is overdue and it is then accepted or indorsed (S. 10). " Fixed Time," i.e. when a bill is expressed to be payable on a specific future date, e.g. " On the 30th September, 19— fixed pay." " Determinable future time," i.e. when a bill is expressed to be payable at a fixed period after date or sight, e.g. " Sixty days after sight pay," or " Three months after date pay " ; or on, or at a fixed period after, the occurrence of a specified event that is bound to happen, e.g. " One year after my death pay." But an instrument drawn payable on or after the occurrence of a specified event that may or may not happen is not a bill of exchange, since no bill can be made payable on a contingency. Thus to draw an instrument in the following terms, " On the arrival of the s.s. *Cormorant* at Southampton pay " is not a bill of exchange, since the *Cormorant* may never arrive at Southampton (S. 11).

(*g*) " A sum certain in money." The sum may be expressed to be payable with interest; or by stated instalments; or by stated instalments with a provision that upon default in payment of any instalment the whole shall become due; or according to an indicated rate of exchange, or a rate of exchange to be ascertained as directed by the bill. Where in a bill the words and figures differ in amount, the amount indicated by the words is the sum payable; and where a bill is payable with interest, unless the instrument otherwise provides, interest runs from the date of the bill, or if it is undated from the issue thereof (S. 9). A bill is not invalid by reason that it is not dated, or ante-dated, or post-dated, or that it bears date on a Sunday (S. 3 [4]). And where a bill expressed to be payable at a fixed period after date is undated, or where the acceptance of a bill payable at a fixed period after sight is undated, any holder may insert what he, in good faith, believes to be the true date of issue or acceptance, and the bill shall be payable accordingly (S. 12)

(*h*) " To or to the order of a specified person." The specified person is termed the *payee* of the bill. A bill is payable to order which is expressed to be so payable, or which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it should not be transferable (S. 8 [4]). The payee must be named or otherwise indicated therein with reasonable certainty. A bill may be made payable to two or more payees jointly, or in the alternative to one of two, or one or some of several payees. A bill may also be made payable to the holder of an office for the time being, e.g. " Pay to the Secretary of the Gas Light and Coke Company " (S. 7).

(*i*) " Or to bearer." A bill is payable to bearer which is expressed to be so payable, or on which the only or last indorsement is an indorsement in blank (S. 8 [3]). Where the payee is a fictitious or non-existing person the bill may be treated as payable to bearer (S. 7).

There are thus primarily three parties to a bill of exchange, viz. drawer, drawee, and payee. But frequently the drawer and the payee are the same person, because the drawer directs payment to be made to himself— " Pay to me [us] or my [our] order." And the drawer and the drawee may be the same person. In the latter case, the holder may treat the instrument, at his option, either as a bill of exchange or a promissory note (S. 5 [2]).

It will be noted that throughout the above legal definition the stress is upon the *certainty* of the instrument. A bill of exchange is evidence of a debt and security for its repayment. It is clear that if an order purporting to be a bill of exchange was encumbered with conditions; or the sum payable, or the time of payment, or the person by whom or to whom payment was to be made was uncertain; or if payment was coupled with, or made contingent upon, the performance of acts other than the payment of the sum expressed to be payable, it

would be practically useless as an instrument of credit designed for general negotiation.

The following illustrate common types of bills :—

> **£300.** LONDON, 8 JOHN STREET, W.C.1.
> *January* 15, 19...
>
> 2d.
>
> On demand pay bearer the sum of Three Hundred Pounds value received.
>
> SIMS, WOODHEAD & CO.
>
> To MR. ROBERT HUDSON,
> 18 BOAR LANE,
> LEEDS.

The above is an example of an inland bill payable not to a specified person but to bearer. The bearer may be Sims, Woodhead & Co., or any person to whom the bill may be negotiated, or the holder of the bill. A bill payable to bearer may be negotiated merely by delivery. The expression "Value received" is commonly used on bills, but it is immaterial whether the words are added or not, since every party whose signature appears on a bill is *prima facie* deemed to have become a party thereto for value (S. 30 [1]). The contrary has to be proved. For the stamp duty on bills, cheques, and promissory notes *see* p. 761.

> **£500.** LONDON, 8 JOHN STREET, W.C. 1.
> *January* 15, 19...
>
> 5s.
>
> Three months after date pay to Messrs. Soames and Walker the sum of Five Hundred Pounds value received.
>
> *per pro.* HOWARD AND FRANCIS, LTD.,
> F. WATKINSON, *Director.*
>
> To MESSRS. BALL & CO.,
> 18 QUEEN STREET,
> CARDIFF.

The above is an example of an inland bill drawn at a determinable future time and payable to a specified person. The effect of drawing a bill payable to A. B. is the same as if it had been drawn payable to

> **£250.** LONDON, 8 JOHN STREET, W.C. 1.
> *January* 15, 19...
>
> 3s.
>
> One month after sight pay to us or our order the sum of Two Hundred and Fifty Pounds value received.
>
> J. J. MANISTY & CO.
>
> To the MAXITONE CO., LTD.,
> BRITANNIA WORKS,
> SOUTHALL.

A. B. or order, or the order of A. B., i.e. the bill must be negotiated by indorsement and delivery.

The third bill on p. 759 is an example of an inland bill drawn at a determinable future time and payable to a specified person, but where drawer and payee are the same person. [*Note.*—Inland bills are not usually drawn after sight, but either on demand, or after date.]

£276 : 10 : 9. LONDON, 8 JOHN STREET, W.C. 1.
January 15, 19...

3s.

Sixty days after sight pay this First of Exchange (Second and Third of the same tenor and date unpaid) to the order of The Westminster Bank, Limited, the sum of Two Hundred and Seventy-Six Pounds Ten Shillings and Ninepence value received.

ALAN, BORTHWICK & CO.

TO MESSRS. CHARLES HOWARD'S SONS,
16 FIFTH AVENUE,
NEW YORK.

£600. LONDON, 8 JOHN STREET, W.C. 1.
January 15, 19...

6s.

Ninety days after date of this First of Exchange (Second and Third of the same tenor and date unpaid) pay to our order the sum of Six Hundred Pounds value received. Exchange as per indorsement.

LANGWORTHY & COMPANY.

TO MESSRS. B. X. FURTADO Y CIA,
CORRIENTES 576,
BUENOS AIRES.

£725. LONDON, 8 JOHN STREET, W.C. 1.
January 15, 19...

8s.

Ninety days after sight of this First of Exchange (Second and Third of the same tenor and date unpaid) pay to the order of The National Bank of India, Limited, the sum of Seven Hundred and Twenty-Five Pounds. Payable at the National Bank of India's drawing rate for demand drafts on London, together with interest at six per cent. per annum from date hereof to approximate due date of the arrival of the remittance in London. Documents to be surrendered on acceptance.

J. J. SANDERSON & CO.

TO MESSRS. CHUNDRA, DUTT & CO.,
ESPLANADE ROW,
MADRAS.

The three bills illustrated above are all foreign bills, the first being

a clean bill, i.e. without shipping documents attached to it, the second a clean bill payable at a rate of exchange to be ascertained as directed by the bill, the third a documentary bill payable at a specified rate of exchange, together with interest as directed by the bill, the shipping documents to be surrendered to the drawees on their accepting the bill.

Exchange as per Indorsement.—The rate of exchange at which the bill is to be paid is usually indicated by a London banker or bill broker, who converts the bill at the time it is sold to him by the drawer at such a rate as will produce for the seller the exact sterling amount of the bill. The indorsement takes the following form: " Pay —— or order at the rate of —— per £1 sterling." The amount converted into foreign currency at the rate indicated is then written below the sterling figures on the face of the bill, and that is the amount in foreign currency to be paid by the drawee. In this way, the English drawer is relieved of any question of loss or gain from fluctuations in the rate of exchange The drawer advises his drawee of the conversion rate. This phrase is not so commonly used on bills as it was before our British banks and financial houses took up the business of foreign exchange dealing.

Inland and Foreign Bills.—There are two classes of bills: (*a*) inland, (*b*) foreign bills. An inland bill is a bill which is or on the face of it purports to be both drawn and payable within the British Islands, or is drawn within the British Islands upon some person resident thereon [but not necessarily payable therein]. Any other bill is a foreign bill. " British Islands " mean any part of the United Kingdom of Great Britain and Ireland, the islands of Man, Guernsey, Jersey, Alderney and Sark, and the islands adjacent to any of them being part of the dominions of His Majesty (S. 4 [1]).

Stamp Duty on Bills and Notes.—By the *Stamp Act*, 1891, amended by the *Finance Act*, 1899, and the *Finance Act*, 1918, the stamp duties on bills and notes are as follows:

	s.	d.
Bill of Exchange payable on demand or at sight, or on presentation, or within three days after date or sight, for any amount	0	2
Bill of Exchange of any other kind whatsoever (except a bank note) and Promissory Notes of any kind whatsoever (except a bank note) drawn, or expressed to be payable, or actually paid or indorsed, or in any manner negotiated in the United Kingdom:—		
Where the amount or value of the money for which the bill or note is drawn or made does not exceed £5 ..	0	2
Exceeds £5 and does not exceed £10	0	2
" £10 " " £25	0	3
" £25 " " £50	0	6
" £50 " " £75	0	9
" £75 " " £100	1	0
For every £100, and also for any fractional part of £100 of such amount or value	1	0

By S. 10 of the *Finance Act*, 1899, where a bill of exchange is drawn

and expressed to be payable out of the United Kingdom, and is actually paid or indorsed or in any manner negotiated in the United Kingdom, and the amount for which the bill is drawn exceeds £50, the stamp duties are reduced as follows :—

Exceeding £50 and not exceeding £100	6d.
Exceeding £100, for every £100 and fractional part of £100	6d.

The stamp on bills payable on demand, or at sight, or on presentation, or within three days after date or sight may be adhesive or impressed, and a twopenny postage stamp or two penny postage stamps may be used for the purpose. All other bills and notes must be drawn on paper impressed before issue with the " bill or note " stamps appropriated to that use, to the required amount of the duty.

Foreign drawn bills if payable on demand or at sight or on presentation or within three days after date or sight may be stamped with an ordinary twopenny postage stamp or with two penny postage stamps. But all other such bills, and all foreign drawn notes must be stamped *ad valorem* with the special adhesive " foreign bill or note stamps " appropriated to this purpose. For stamping purposes, a bill of exchange or promissory note which purports to be drawn or made out of the United Kingdom is to be deemed to have been so drawn or made, although it may in fact have been drawn or made within the United Kingdom. The Channel Islands and the Isle of Man are regarded as foreign countries so far as stamp duty is concerned, and bills and notes drawn or made therein require stamping as foreign drawn bills or notes. In all other respects such bills and notes are inland bills and notes.

Acceptance of Bill.—With the exception of the first bill illustrated on p. 759, which is drawn payable on demand, and which, therefore, is presented to the drawee but once and that for payment, all the other bills will, in accordance with commercial practice, first be presented to the drawees as soon as possible for acceptance, and after acceptance be again presented to the drawees (now the acceptors) on the due dates for payment.

A bill is presented for acceptance in order to make the drawee a party liable on the bill, and so render it the more easily negotiable. Clearly, any person could write out an order calling upon another person to pay a sum of money, but until that other person has assented to the drawer's order upon him, he is under no liability on the bill. But the bill is perfectly valid without acceptance, and the drawer is liable to any person who may become a party to the bill by indorsement in the course of its negotiation prior to acceptance, and so also is any indorser of such a bill to a subsequent indorser, or to the holder.

S. 39 of the Act mentions three instances where the holder of a bill *must* present it for acceptance, viz. (*a*) where a bill is payable after sight. This is necessary in order to fix the day of payment, (*b*) where the

bill expressly states that it shall be presented for acceptance, (*c*) where a bill is drawn payable elsewhere than at the residence or place of business of the drawee. But, as already stated, it is the usual commercial practice to obtain acceptance of all bills not payable on demand at the earliest possible moment.

Form of Acceptance.—The drawee of a bill assents to the drawer's order upon him by writing across the face of the bill the word "accepted," and underneath that word his signature. He need not himself sign the bill; he may accept the bill by the hand of his agent duly authorised for that purpose. The word "accepted" is not really necessary, although it is invariably used. The signature is the vital thing that constitutes assent. The acceptances of the bills—illustrations 1 and 4 above—would take the following forms:—

Accepted.
ROBERT HUDSON.

Or

Accepted.
Payable at Barclays Bank,
36 Briggate, Leeds.
ROBERT HUDSON.

Or

Accepted.
per pro. ROBERT HUDSON,
JOHN WILKES, *Agent.*

Or

Accepted.
Payable at Barclays Bank,
36 Briggate, Leeds.
per pro. ROBERT HUDSON.
JOHN WILKES, *Agent.*

Sighted, January 25, 19...
Accepted.
Payable at First National Bank,
Broadway, New York.
CHARLES HOWARD'S SONS.

Sighted, January 25, 19...
Accepted.
CHARLES HOWARD'S SONS.

The place where the bill is made payable is called the *domicile* of the bill. In example 4, it is necessary to state the day on which the bill was sighted, i.e. the day on which it was presented for acceptance, in order to fix the day of payment, which in this instance is the 60th day from January the 25th. There are no days of grace in the United States.

General and Qualified Acceptances.—The forms of acceptance shown above are *general* acceptances because they assent to the drawers'

orders without qualification. But by S. 19 an acceptance may be *qualified*. The acceptance may make payment *conditional*, e.g. it may make payment contingent upon the surrender of shipping documents; or it may be a *partial* acceptance, as, e.g., where a bill for £100 is accepted payable for £50; or it may be qualified in time, as, e.g., where a bill drawn payable sixty days after sight is accepted payable ninety days after sight; or it may be the acceptance of one or more of the drawees of a bill but not of all; or it may confine payment to a particular specified place. But an acceptance to pay at a particular place is not qualified unless it expressly states that payment is to be made at that place only.

By S. 44, the holder of a bill is not bound to take a qualified acceptance and may treat the bill as dishonoured by non-acceptance if he cannot obtain a general acceptance. The holder of a bill who has taken a qualified acceptance should give immediate notice to the drawer and indorsers of the bill, and if these do not within a reasonable time express their dissent to the holder they are deemed to have assented thereto. If the drawer or any indorser dissents, he is discharged from liability on the bill. Where the acceptance is partial, i.e. for part only of the amount, notice of the fact given by the holder to the drawer or any indorser operates to prevent his discharge from the bill.

Rules as to Presentment.—Presentment for acceptance must be made by or on behalf of the holder of the bill to the drawee or to some one authorised to accept or refuse acceptance on his behalf at a reasonable hour on a business day and before the bill is overdue. Where a bill is addressed to two or more drawees, who are not partners, presentment must be made to them all, unless one has authority to accept for all, then presentment may be made to him only. Where the drawee is dead, presentment may be made to his personal representative; where he is bankrupt, to him or his trustee. Where authorised by agreement or usage, presentment through the post is sufficient (S. 41 [1]).

Presentment according to the above rules is excused, and the bill may be treated as dishonoured by non-acceptance, where the drawee is dead or bankrupt, or is a fictitious person, or a person not having capacity to contract by bill [e.g. an infant], or where, after the exercise of reasonable diligence, presentment cannot be effected, or where, although the presentment has been irregular, acceptance has been refused upon some other ground (S. 41 [2]).

It is customary to allow the bill to remain with the drawee for a period of 24 hours, after which time he must deliver up the bill to the presenter on demand, or return it through the post if it has been presented for acceptance through the post. If the drawee declines to accept, he usually states his reason when delivering up the bill, e.g. "No advice," "Not in order," etc.

When a bill payable after sight is negotiated, the holder must either present it for acceptance or negotiate it within a reasonable time. If he does not do so, the drawer and all indorsers prior to the holder are discharged. What is reasonable time is determined by the nature of the bill, the usage of trade with respect to similar bills, and the facts of the particular case (S. 40).

When a bill is duly presented for acceptance and is not accepted within the customary time, the person presenting it must treat it as dishonoured by non-acceptance. If he do not, the holder shall lose his right of recourse against the drawer and indorsers (S. 42). When a bill is dishonoured by non-acceptance, an immediate right of recourse against the drawer and indorsers accrues to the holder, and no presentment for payment is necessary (S. 43 [2]). *See* Dishonour of Bill, p. 767.

Presentment for Payment.—A bill must be duly presented for payment, for if not the drawer and indorsers are discharged. A bill not payable on demand must be presented on the day it falls due. A bill payable on demand must be presented within a reasonable time after issue to make the drawer liable, and within a reasonable time after indorsement to make the indorser liable. "Reasonable time" means reasonable having regard to the nature of the bill, trade usage with regard to similar bills, and the facts of the particular case.

Presentment for payment must be made by the holder, or a person authorised by him to receive payment, at a reasonable hour, on a business day, at the proper place, to the person designated by the bill as payer, or to some person authorised by him to pay or refuse payment.

"Proper place" means the place of payment specified in the bill, e.g. the bank where a bill is domiciled; or, where no place is specified the address of the drawee or acceptor given in the bill; or, where no place of payment is specified and no address given, the drawee's or acceptor's place of business if known, and if not, his ordinary residence if known; or in any other case at whatever place the drawee or acceptor can be found, or his last known place of business or residence.

Where a bill is presented at the proper place, and after the exercise of reasonable diligence no person authorised to pay or refuse payment can be found, no further presentment to the drawee or acceptor is required.

Where a bill is drawn upon or accepted by two or more persons who are not partners, and no place of payment is specified, presentment must be made to them all. Where the drawee or acceptor is dead, and no place of payment is specified, presentment must be made to a personal representative if such there be, and with the exercise of reasonable diligence he can be found.

Where authorised by agreement or usage presentment through the post office is sufficient (S. 45).

Delay in presentment for payment is excused when the delay is caused by circumstances beyond the holder's control, and not imputable to his default, misconduct, or negligence. But when the cause of delay ceases to operate presentment must be made with reasonable diligence.

Presentment for payment is dispensed with where presentment as required by the Act cannot be effected; where the drawee is a fictitious person; as regards the drawer, where the drawee or acceptor is not bound, as between himself and the drawer, to accept or pay the bill, and the drawer has no reason to believe that the bill would be paid if presented; as regards an indorser, where the bill was made for his accommodation, and he has no reason to expect that the bill would be paid; by waiver of presentment, express or implied (S. 46).

Days of Grace.—Where a bill is drawn payable after date or after sight, it is the law in this country that, unless the bill by its terms provides otherwise, the due date of payment is three days after the determinable date fixed by the bill.

By S. 14, where a bill is not payable on demand, the day on which it falls due is determined as follows:—

(1) Three days, called days of grace, are, in every case where the bill does not otherwise provide [e.g. where the bill is payable on a date *fixed*, or is made payable without days of grace], added to the time of payment as fixed by the bill, and the bill is due and payable on the last day of grace.

But inasmuch as bills and cheques are payable only on business days (and within banking hours), S. 14 also provides as follows:—

(*a*) When the last day of grace falls on Sunday, Christmas Day, Good Friday, or a day appointed by Royal Proclamation as a public fast or thanksgiving day, the bill is due and payable on the preceding business day.

(*b*) When the last day of grace is a bank holiday (other than Christmas Day or Good Friday), under the *Bank Holidays Act*, 1871, and Acts amending or extending it, or when the last day of grace is a Sunday, and the second day of grace is a bank holiday, the bill is due and payable on the succeeding business day.

Where a bill is payable at a fixed period after date or sight or the happening of a specified event, the time of payment is determined by excluding the day from which the time is to begin to run, and by including the day of payment.

Where a bill is payable at a fixed period after sight, the time begins to run from the date of acceptance, or if the bill is noted or protested for non-acceptance or for non-delivery from the date of noting or protesting.

The term "month" in a bill means calendar month. [A bill dated,

for example, April 30 and drawn payable one month after date becomes due for payment on June 2, and not on June 3. No account is taken of " lacking " days. Thus a bill dated January 31 payable two months after date is due for payment on April 3.]

Dishonour of Bill.—A bill payable on demand can be dishonoured in one way only, viz. by non-payment. A bill payable after sight or date may be dishonoured in one of two ways, viz. (*a*) by non-acceptance, (*b*) non-payment. When a bill is dishonoured by non-acceptance, an immediate right of recourse against the drawer and indorsers accrues to the holder, and no presentment for payment is necessary (S. 43). And that right of recourse becomes a right of action against all prior parties to the bill as soon as the holder has given due notice of dishonour to those parties, and, where necessary, has had the bill protested. Similarly, where a bill is dishonoured by non-payment, the holder has an immediate right of recourse against each party to the bill, which crystallises into a right of action against them as soon as he has given them due notice of dishonour, and, where required, has had the bill protested. But it is not necessary in order to take proceedings against the drawee or acceptor of a dishonoured bill to protest the bill or give him notice of dishonour (S. 52 [3]). The drawer of a bill and any indorser thereof to whom due notice of dishonour is not given is discharged from liability on the bill (S. 48).

Notice of Dishonour.—This matter is dealt with in Sections 48 to 50 of the Act.

No special form of notice is laid down by the Act, but the terms of the notice must sufficiently identify the bill. Notice may be given orally or in writing. If written, the notice need not be signed. If the notice is duly addressed and sent through the post, notice is deemed to have been given, notwithstanding any miscarriage by the Post Office

Usually, notice takes the form of a letter from the holder or his agent in that behalf, to the party he seeks to charge, or to that party's agent, intimating the fact of dishonour either by non-acceptance or non-payment, giving particulars of the bill and the parties thereto, and requesting immediate payment of the amount of the bill plus any expenses incurred. As between collecting banker and customer, the return to the latter of a dishonoured bill is in point of form deemed sufficient notice of dishonour.

Notice must be given by or on behalf of the holder, or by or on behalf of an indorser who is himself liable on the bill at the time notice is given. So, if any party to a dishonoured bill be discharged for want of notice, or for want of notice within reasonable time, that party cannot give effectual notice of dishonour. Notice may be given as soon as the bill is dishonoured, and must be given within a reasonable time thereafter. In the absence of special circumstances, reasonable time means (*a*) where the person giving and the person to receive notice reside in the same town, the notice is sent off in time to reach the

latter the day after dishonour; (*b*) where they reside in different places, the notice is sent off the day after dishonour, if there be a post at a convenient hour on that day, and if not by the next post thereafter.

Where a bill is in the hands of an agent, as, e.g., where one banker employs another banker as agent for collection, both agent and principal have each the same time in which to give notice of dishonour, and any party to a bill receiving due notice has also the same time for giving notice to prior parties to the bill.

Where the drawer or indorser is dead, and the party giving notice knows it, notice must be given to a personal representative if such there be, and with the exercise of reasonable diligence he can be found. Where the drawer or indorser is bankrupt notice may be given to the bankrupt or to the trustee. Where there are two or more drawers or indorsers who are not partners, notice must be given to each, unless one of them has authority to receive notice for the others.

Delay in giving notice is excused where the delay is caused by circumstances beyond the control of the party giving notice, and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate the notice must be given with reasonable diligence.

Notice is dispensed with when, after the exercise of reasonable diligence, notice cannot be given, or fails to reach the person sought to be charged; or, when notice is expressly or impliedly waived; as regards the drawer, where drawer and drawee are the same person, or where the drawee is a fictitious person, or a person incapable of contracting by bill, or where the drawer is the person to whom the bill is presented for payment, or where the drawee or acceptor as between himself and the drawer is under no obligation to pay the bill, or where the drawer has countermanded payment. As regards the indorser, where the drawee is a fictitious person, or a person not having capacity to contract, and the indorser was aware of the fact at the time he indorsed the bill; or where the indorser is the person to whom the bill is presented for payment; or where the bill was accepted or made for his accommodation.

Noting and Protesting.—Where an *inland* bill is dishonoured it *may* be noted and protested, but, except where an inland dishonoured bill is to be accepted or to be paid for honour, noting and protesting are not legally necessary. But a dishonoured *foreign bill*, whether it be dishonoured by non-acceptance or by non-payment, must be protested, otherwise the drawer and indorsers are discharged. And a foreign bill that has been protested for non-acceptance, and afterwards been presented unsuccessfully for payment, may again be protested for non-payment. It is necessary that the fact of dishonour should, in the case of foreign bills, be indisputably established, and a notary's certificate of dishonour is everywhere accepted as conclusive proof of the fact. The dishonoured bill is handed, immediately on dishonour, to

a notary public, and that functionary must re-present the bill to the drawee or acceptor not later than the next business day following the day of dishonour (*Bills of Exchange (Time of Noting) Act*, 1917).

Noting consists of a memorandum written on the bill consisting of the date, the charges for noting, a reference to the Notary's register containing particulars of dishonoured bills, and his own initials. The Notary also attaches to the bill a slip on which he writes the reason for dishonour, if any is given to him. Protest is an extension of the act of noting. It consists of a formal certificate given by the Notary, containing a copy of the bill, specifying the name and address of the person to whom he presented it, and of the person on whose behalf, and the date on which he presented it, and the answer given to him, or else the fact that the drawee or acceptor could not be found. The formal protest need not be made at the time of noting, but may be extended at any time, as of the date of noting, prior to bringing an action on the bill. Protest is dispensed with in circumstances which would dispense with notice of dishonour, and delay in noting or protesting is excused in circumstances that would excuse delay in giving notice of dishonour (S. 51).

Acceptance and Payment for Honour.—By S. 15, the drawer or any indorser of a bill may insert therein the name of a person to whom the holder may resort should the bill be dishonoured by non-acceptance or non-payment. Such a person is called the *referee in case of need* [or more briefly the *case of need*]. The holder may or may not resort to the case of need at his option. The mention of a case of need in a bill does not make him a party to the bill, but he may become a party to it, if the holder, having first protested the bill for non-acceptance or non-payment, resorts to him, and he accepts, or pays, the bill for honour.

By S. 65, where a bill has been protested for dishonour by non-acceptance, and it is not overdue, any person not already liable on the bill may with the holder's consent intervene and accept the bill *suprà* protest for the honour of any party liable thereon, or for the honour of the person for whose account the bill is drawn. Such an acceptance is known as an *acceptance for honour suprà protest*, and to be valid it must be written on the bill and indicate that it is an acceptance for honour, and be signed by the acceptor for honour. Where the acceptance for honour does not state for whose honour it is made, it is deemed to be an acceptance for the honour of the drawer. The maturity of a bill payable after sight and accepted for honour is calculated from the date of noting for non-acceptance.

By S. 66, the acceptor for honour engages that he will, on due presentment, pay the bill if it is not paid by the drawee, provided that the bill is protested and due notice of these facts is given to him. He is liable to the holder and to all parties to the bill subsequent to the party for whose honour he accepts the bill.

By S. 68, where a bill has been protested for non-payment, any person may intervene and pay it *suprà* protest for the honour of any party liable thereon, or for the honour of the person for whose account the bill is drawn. Such a payment is known as *payment for honour suprà protest*. Where a bill has been paid for honour, all parties subsequent to the party for whose honour the bill is paid are discharged. The payer for honour is subrogated to the holder, i.e. he, so to speak, steps into the holder's shoes, and has all the holder's rights against, and is subject to all the holder's duties to, the person for whose honour he pays, and all parties liable on the bill to that person.

It is to be noted that an acceptance for honour can be made only by consent of the holder, and the acceptor for honour must not prior to his acceptance be liable on the bill, and the bill must not be overdue. If the holder consents to a person accepting for honour, he loses his immediate right of recourse against prior parties to the bill. It is therefore but just that the holder should have the right to say whether he will accept a case of need, or an intervener for honour, and await the result of presentment for payment to the case of need or the intervener rather than take action at once on the bill dishonoured by non-acceptance. But the consent of the holder is not necessary to the intervention of a payer of the bill for honour, and the intervener may already be liable on the bill. Further, it is clear that the bill must be overdue before he intervenes. A holder cannot look for more than payment of the bill according to its tenor, and, if he refuses payment *suprà* protest, he loses his right of recourse against any party to the bill who would have been discharged by such payment.

It is the usual practice for acceptances for honour to be attested by a notary, and, by S. 68 (3), a payment for honour must be so attested in order to operate as such.

Amount Recoverable on Dishonoured Bill.—By S. 57, where a bill is dishonoured, the measure of damages, which shall be deemed to be liquidated damages [i.e. agreed damages, the amount of which cannot be questioned] shall be: the amount of the bill; interest thereon from the time of presentment for payment, if the bill is payable on demand, and from the maturity of the bill in any other case [usually at 5 % p.a.]; the expenses of noting, and the expenses of protest if protest is necessary and has been extended. Interest may be payable by the terms of the bill itself. This applies to bills dishonoured in this country. Where a person is liable on a bill and it is dishonoured in a foreign country wherein it is payable, the measure of damages is the amount of the *re-exchange* with interest thereon until the time of payment, plus expenses. Re-exchange means the amount in sterling that would have been required to produce in the place of payment at the time of dishonour the exact amount of foreign currency for which the bill is drawn, or expressed to be payable.

Liability of Parties to a Bill.—By S. 54, the acceptor is the

person primarily liable on a bill, for he it is who contracts to pay it according to the tenor of his acceptance. By accepting, he acknowledges the existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the bill; and, if the bill is drawn to the drawer's order, the capacity of the drawer to indorse, but not the genuineness or validity of his indorsement; and, if the bill is payable to the order of a third person, the existence of the payee and his then capacity to indorse, but not the genuineness or validity of his indorsement. The acceptor cannot deny any of these things to a holder in due course of a bill; and he can seldom have any ground of defence against an action for the amount of the bill brought against him by such a holder, except in the case of forgery.

As to forgery, S. 24 says that a forged or unauthorised signature on a bill is wholly inoperative, and no right to retain a bill or to give a discharge therefor or to enforce payment thereof against any party thereto can be acquired through or under that signature, unless the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery or want of authority [e.g., where the party sought to be charged has by his conduct led the other party to believe the forged signature to be genuine, or has not repudiated the forgery as soon as it was brought to his notice].

By S. 55 (1), the drawer of a bill engages that on due presentment it shall be accepted, and paid according to its tenor, and that if it is dishonoured he will compensate the holder or any indorser who is compelled to pay it, provided that the requisite proceedings on dishonour be duly taken. He cannot deny to a holder in due course the existence of the payee and his then capacity to indorse.

By S. 55 (2), the liability of an indorser is similar to that of the drawer, but whereas the drawer is liable to the holder or any indorser who is compelled to pay the bill, an indorser is liable only to the holder and those indorsers subsequent to himself, provided that the requisite proceedings on dishonour be duly taken. An indorser cannot deny to a holder in due course the genuineness and regularity in all respects of the drawer's signature, and all previous indorsements, and to his immediate or a subsequent indorsee that the bill was at the time of his indorsement a valid and subsisting bill, and that he had then a good title thereto.

Where there are two or more indorsements on a bill, each indorsement is deemed to have been made in the order in which it appears on the bill, until the contrary is proved (S. 32 [5]).

Where a bill is dishonoured by non-acceptance, the drawee is not liable on the bill, and the drawer's remedy against the drawee is to sue him not on the bill itself, to which he is not a party, but for the consideration in respect of which the bill was drawn. But the holder of such a bill may sue all parties to the bill, provided he has given, or they have in fact received, due notice of dishonour. Where an

accepted bill is dishonoured by non-payment, the acceptor is the person primarily and ultimately liable on the bill, and the liability will be forced back from the holder, through each indorser in the order in which he indorsed, to the drawer, and by him upon the acceptor. But provided that the holder has given due notice of dishonour to each party to the bill, or each party (other than the acceptor) has in fact received due notice through other parties to the bill, the holder can, if he fails to secure payment from his own indorsee, proceed against any other indorsee or against the drawer, for each party to the bill is severally liable upon it. Usually, however, the holder looks to his own immediate indorsee for payment, and is paid by him, and the indorsee who pays the holder looks to his own immediate indorsee and is paid by him, and so the liability is forced back upon the drawer, who, having paid, is left with his legal remedy against the acceptor.

Holder and Holder in Due Course.—Both these terms have been used above, and it is necessary to understand their precise significance. By S. 2, the holder of a bill is the payee or indorsee of a bill or note who is in possession of it, or the bearer thereof. A mere holder may, however, be infected with notice of some defect in the title to the instrument of the person who negotiated it to him, and for that reason be unable to enforce payment of it. Opposed to a bare holder is a holder in due course. By S. 29, a holder in due course of a bill is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, viz. that he became the holder of it before it was overdue, and without notice that it had been previously dishonoured, if such was the fact; that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.

Value is defined in S. 27 as follows:—

Valuable consideration for a bill may be constituted by any consideration sufficient to support a simple contract [all contracts by bill are simple contracts]; an antecedent debt or liability. Where value has at any time been given for a bill, the holder is deemed to be a holder for value as regards the acceptor and all parties to the bill who became parties prior to such time. Where the holder of a bill has a lien on it, arising either from contract or by implication of law, he is deemed to be holder for value to the extent of the sum for which he has a lien.

The difference in the position of a holder and a holder in due course may be simply explained as follows: A draws a bill upon B for the price of goods sold to B, which B accepts. A then negotiates the bill to C. It turns out that the goods are defective and rejected by B, who dishonours the bill on presentment for payment. A cannot recover the amount of the bill from B, because the consideration for the bill has failed. But if C has given value for the bill to A, and has taken it in good faith, knowing nothing of the facts, and before it was overdue, then C is holder in due course of the bill and can recover the amount

either from B or from A. If, on the other hand, C was aware that the consideration for the bill had failed at the time he took it, he would be a holder of the bill but not a holder in due course, and would have no better right to enforce payment against B than A had.

Again, suppose D to be the holder of an overdue bill, and he negotiates the bill to E. Then since E takes the bill when it is overdue, he cannot be a holder in due course of the bill. So if D has a right to enforce payment E has as good a right, but if D has no right E has no right.

The date shows whether a bill not payable on demand is overdue or not. A bill payable on demand is deemed to be overdue when it has been in circulation for an unreasonable time. What is an unreasonable time is a question of fact (S. 36 [3]).

No one can become a holder in due course of a bill who takes it with notice that it has been dishonoured, but if a person *bonâ fide* takes such a bill without notice of the dishonour he is a holder in due course (S. 36 [5]).

No one can become a holder in due course of a bill if it is vitiated by a prior forgery, or if the bill is void under any Statute. But if a person takes a bill drawn payable to bearer, or which has become payable to bearer by a genuine indorsement in blank, from a person who has found or stolen such a bill, and who is therefore a wrongful holder, and he does so in circumstances that satisfy the definition of a holder in due course contained in S. 29, then he is such a holder, and can sue all parties to the bill, for he is not affected by the fact that his transferor had no title to the bill.

Negotiation of Bill.—The negotiation of bills is governed by Sections 31 to 37 of the Act.

A bill is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder of the bill. A bill payable to bearer is negotiated by delivery. A bill payable to order is negotiated by the indorsement of the holder completed by delivery.

Indorsement consists of the holder's signature written on the back of the bill, or on an allonge, or on a " copy " of a bill issued or negotiated in a country where " copies " are recognised. [An allonge is a piece of paper gummed to the bill in order to accommodate further indorsements when the back of the bill is already full.]

Where in a bill payable to order, the payee or indorsee is wrongly designated or his name is misspelt, he may indorse the bill as therein described, adding, if he think fit, his proper signature.

If a bill be made payable to " A. B." or to " A. B. or order," or " to the order of A. B.," and A. B. indorses the bill without specifying the indorsee, the indorsement is an *indorsement in blank*, and the bill is then payable to bearer and can be negotiated thereafter by delivery alone.

If A. B., when indorsing the bill, specifies the indorsee, e.g. "Pay C. D. or order, A. B." the bill is still an order bill, and C. D. must negotiate it by indorsement and delivery. Such an indorsement is termed a *special indorsement.*

When a bill has been indorsed in blank, any holder may convert the blank indorsement into a special indorsement by writing above the indorser's signature a direction to pay the bill to or to the order of himself or some other person.

In the commercial practice of this country it is the invariable rule to negotiate a bill by indorsement and delivery, since, naturally, in all cases, the transferee of a bill desires his transferor to be a party liable on the bill.

An indorsement must be an indorsement of the entire bill, it cannot purport to transfer a part only of the amount to the transferee; and it cannot purport to transfer the bill to two or more indorsees severally; and it cannot be a conditional indorsement, for, if it is, the condition can be disregarded. But an indorsement may be a *restrictive indorsement* prohibiting further negotiation of the bill, as, e.g., where the indorsement takes the following forms: "Pay A. B. only"; or "Pay A. B. for the account of C. D."; or "Pay A. B. for collection."

Where a bill is payable to the order of two or more payees, or indorsees who are not partners, all must indorse, unless one has authority to indorse for the other or others.

Principal and Agent.—No person is liable as a party to a bill who has not signed it as such, but if a person signs a bill in a trade or assumed name he is just as liable as if he had signed his own name. A partner signing the name of his firm makes the firm and each member of the firm liable on the bill, provided the partner signing was acting within the scope of his authority (S. 23).

Generally speaking, whatever contract a person may make in his own name he may also make through his duly appointed agent. An agent who signs his own name only to a bill makes himself personally liable on the bill but not his principal, and he is also personally liable though he adds merely descriptive words to his signature. For example, an agent who, purporting to accept a bill on behalf of his principal, signs in the form "A. B., agent" is alone liable on the bill. To negative personal liability, the agent's signature must clearly show that he is signing in a representative capacity, e.g. thus: "per pro." (or "for and behalf of") "Jonathan Edwards, James Brown"; or "For and behalf of The Alliance Trading Company, Ltd., Howard Jenkins, Managing Director." A signature by procuration operates as notice that the agent has but a limited authority to sign, and puts the person taking an instrument so signed on enquiry as to the scope of the agent's authority, for if the agent is exceeding his authority in so signing, the principal is not bound by the signature (SS. 25

and 26). The agent, however, is liable in damages for having pretended to an authority that he did not possess.

By S. 31, where any person (e.g. an agent) is under obligation to indorse a bill in a representative capacity, he may indorse the bill in such terms as to negative personal liability. He does this by adding to his signature the words "Sans Recours," or "Without recourse to me."

Discharge of Bill.—A bill is discharged when all rights of action on the bill are extinguished. But although the bill itself be discharged, there may still exist rights of action arising out of the transaction in respect of which the bill was drawn. For example, if a person accepts a bill for the accommodation of a person not liable on the bill, and he pays it, the bill is discharged, but the acceptor still has a right of action against the person for whose accommodation he accepted the bill.

A bill may be discharged in five ways:

(1) By payment in due course. Payment in due course means payment made at or after the maturity of the bill to the holder thereof in good faith and without notice that his title to the bill is defective. Payment by the drawer or an indorser does not discharge the bill for both still have rights of action on the bill (S. 59 [1]).

(2) When the acceptor becomes the holder of it at or after its maturity in his own right, i.e. when in the course of its negotiation it is negotiated back to the acceptor. By such *circuity of action* the right of the acceptor as holder of the bill cancels his liability upon it as acceptor (S. 61).

(3) When the holder of a bill at or after its maturity absolutely and unconditionally renounces his rights against the acceptor. The renunciation must be in writing, unless the bill is delivered up to the acceptor (S. 62 [1]).

(4) When a bill is intentionally cancelled by the holder or his agent, and the cancellation is apparent. Any party liable on a bill may be discharged by the holder or his agent intentionally cancelling that party's signature. Such cancellation serves to discharge all indorsers subsequent to the party discharged, but the bill is undischarged as regards other parties to the bill (S. 63).

(5) When a bill or acceptance is materially altered without the assent of all parties liable on the bill, the bill is avoided except as against a party who has himself made, authorised, or assented to the alteration, and subsequent indorsers. The following alterations are material, viz. alterations of date, sum payable, time of payment, place of payment, and where a bill has been accepted generally, the addition of a place of payment without the acceptor's assent (S. 64).

An immaterial alteration has no effect, and where a bill has been materially altered and the alteration is not apparent, a holder in due course has the same rights under the bill as he would have if it had not been altered (S. 64).

Accommodation Parties and Bills.—A person who signs a bill as drawer, acceptor, or indorser without receiving value for so doing, and for the sole purpose of enabling the person to whom he lends his name to raise money is termed an *accommodation party*. The person accommodated is bound to provide funds to discharge the bill at maturity, but, whether he does so or not, the person accommodating may be compelled to pay the bill to any holder of the bill for value. If a person takes an accommodation bill for value, it is immaterial whether, at the time of taking it, he knew that the party from whom he took it was an accommodation party.

An *accommodation bill* is a bill which is accepted, without the acceptor receiving value for so doing, in order to accommodate some other person who may or may not be liable on the bill. Such an acceptor, although primarily liable thereon, is not the principal debtor on the bill, but a surety for the party whom he accommodates, and that party is bound to provide the acceptor with funds to meet the bill at maturity (S. 28).

Bill in a Set.—Inland bills are not drawn in a set, but foreign bills usually are—Continental bills in a set of two, bills on more remote countries in a set of three. Bankers' drafts are commonly drawn in sets of two marked " Original " and " Duplicate." Each bill of the set is numbered and contains a reference to the other part or parts. The examples on p. 760 illustrate a bill in a set. Each part is worded alike, except that the second part would read " Pay this Second of Exchange (first and third of the same tenor and date unpaid)," and the third part " Pay this Third of Exchange (first and second of the same tenor and date unpaid). " The first of Exchange is sent forward by one mail, and the second by a subsequent mail, hence the latter is called the *secunda via*.

One part only of such a bill is stamped, since all three (or two) parts constitute but one bill. One part only, usually the first that comes to hand, is presented for acceptance and accepted. If more than one part were accepted, the acceptor would be liable on each accepted part as separate bills to different holders in due course of such parts. Further, the holder of the bill, if he indorsed more than one part, would be liable to a holder in due course of each part that he had indorsed. And if the acceptor paid the bill, without requiring the part that he had accepted to be delivered up to him, he would be liable to a holder in due course of the part that he had accepted. With these exceptions payment of one part discharges the whole bill (S. 71).

II. Cheques.

A cheque is a specialised bill of exchange. It is legally defined in S. 73 as " a bill of exchange drawn on a banker payable on demand."

The definition of a bill of exchange, set out on p. 756, applies equally to a cheque, except that a cheque must always be payable on demand, and always be drawn upon a banker. The law applicable to bills of exchange payable on demand applies generally to cheques, with such exceptions as are set out in Pt. III of the Act of 1882, and briefly noted below.

As with other bills of exchange, so with cheques. To every cheque there are primarily three parties, viz. drawer, drawee (a banker), and payee. But frequently the drawer and payee are the same person, because the drawer directs payment to himself.

A cheque, being payable on demand, is not presented to the drawee banker for acceptance but only for payment, and the banker is bound to pay the cheque only so long as he holds funds of the drawer sufficient to pay it, or within the limits of any overdraft the banker may have agreed to allow the drawer. If a banker wrongfully refuses to pay a customer's cheque, he is liable to an action for damages for injury to the customer's credit.

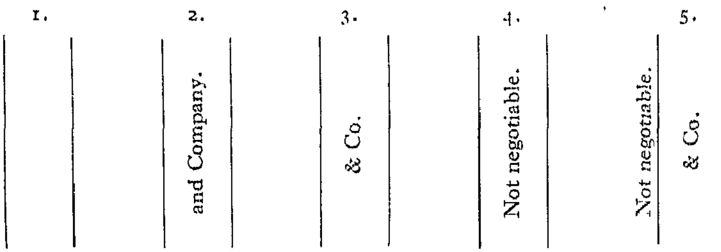
Dishonour of Cheque.—When a banker dishonours a cheque, the drawer is entitled to notice of dishonour, but notice is dispensed with when (*a*) the drawer has no funds or insufficient funds to his credit, and has therefore no reason to expect that the cheque will be paid; or (*b*) when the customer has countermanded payment; or (*c*) when the banker has had notice of the drawer's death, or of an act of bankruptcy committed by him, or of an assignment by the drawer of his available balance at the bank, or of a garnishee order restraining the drawer from operating upon the account, or where the banker has knowledge that a breach of trust is intended by the drawer in drawing the cheque, or, in the case of a company, of its winding up. In other circumstances, for example, where a cheque is irregularly drawn, the banker should give due notice to the customer.

When dishonouring cheques, the banker marks upon them the reason for dishonour. If the reason be insufficiency of funds, the best answer is R/D = refer to drawer, although N/S = not sufficient funds, is also used when the circumstances justify this marking. Other markings, where appropriate, are "Words and figures differ," "Indorsement irregular," "Effects not yet cleared," "Second signature required," etc. By recent resolution of the Clearing House, answers must be written *in full* on the instrument.

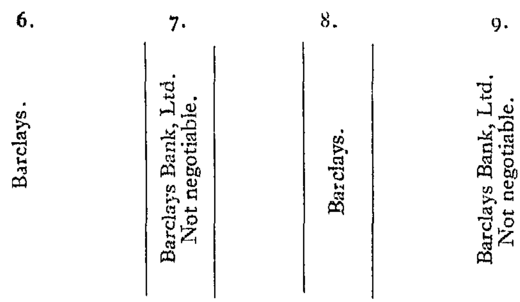
Crossed Cheques.—A cheque may be crossed generally or specially. A *general crossing* consists of the words "and Company" or any abbreviation thereof, between two parallel transverse lines, either with or without the words "not negotiable"; or two parallel lines simply, either with or without the words "not negotiable." A *special indorsement* consists of an addition across the face of the cheque of the name of a banker, either with or without the words "not negotiable" (S. 76).

The following illustrate a few forms of crossing :—

General Crossings.



Special Crossings.



By S. 77, a cheque may be crossed generally or specially by the drawer. Where a cheque is uncrossed, the holder may cross it generally or specially. Where a cheque is crossed generally or specially, the holder may add the words "not negotiable." Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker for collection. Where an uncrossed cheque, or a cheque crossed generally, is sent to a banker for collection, he may cross it specially to himself. A crossing authorised by the Act is a material part of the cheque; it shall not be lawful for any person to obliterate or, except as authorised by the Act, to add to or alter the crossing.

Non-Statutory Additions to Crossing.—The words "Payee's Account," "Payee's Account only," "Account of A. B.," "Under £10," and variants thereof, are frequently found on cheques in close proximity to the crossing. These have no statutory significance. The

first and third additions are a direction to the collecting banker to collect the cheque for, and to place the proceeds to the credit of, the named payee, and if he were to place the proceeds to the credit of any other account, he would be guilty of negligence. The fourth addition is a protective device to prevent fraudulent raising of the amount of the cheque. The second addition places the paying banker in some difficulty and is therefore objectionable. He would be justified in refusing payment of a cheque with this marking if it were an open cheque presented across the counter for payment, since he is not in a position to identify the payee, and he would also be justified in refusing payment, if the cheque bearing these words were a crossed cheque that bore evidence of having passed through the hands of a person other than the named payee.

The holder of a cheque payable to bearer, or the holder of an uncrossed cheque payable to order, can himself obtain payment of the cheque across the counter by presenting it to the drawee banker, he having, in the second case, first indorsed the cheque. The holder of a cheque crossed generally cannot obtain payment except by having it presented to the drawee banker through another banker. The holder of a cheque crossed specially can obtain payment only through the banker named in the crossing. A banker may pay a cheque crossed generally only to another banker, and a cheque crossed specially only to the named banker. If he pays a cheque in a manner inconsistent with the crossing, and loss ensues, he cannot debit the drawer's account, and he is liable to the true owner of the cheque, i.e. the person who is legally entitled to the cheque and its proceeds. A banker is in general accountable only to his customer; his liability to the true owner in the circumstances mentioned is an exception to this rule.

Indorsement of Cheques.—The indorsement of bills and cheques must conform to the designation of the indorser as indicated either on the face of the bill or cheque, or in a special indorsement thereof. By S. 32 (4) where the payee or indorsee is wrongly designated, or his name is misspelt, he may indorse the bill as therein described, adding, if he think fit, his proper signature. The correctness or incorrectness of an indorsement is, in the main, determined by banking and mercantile custom. No rules can be laid down that will meet all cases. The experience of a practical banker is the best guide, and the student is therefore referred to H. P. Sheldon's *Practice and Law of Banking*, 3rd Edition, pp. 17–49, where the subject is exhaustively treated.

Not Negotiable Crossing.—By S. 81, a person who takes a crossed cheque which bears on it the words "not negotiable" shall not have and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had. The words "not negotiable" have no significance apart from one of the recognised crossings, and, when added to such a crossing, they in no way

impair the transferability of the cheque. What they do is to destroy its negotiability. The distinctive feature of negotiability is that a holder of a negotiable instrument, who has taken it in good faith, and for value, and without notice of any defect in the title of the person from whom he took it, in all cases, except when the instrument bears a forged signature, acquires an indefeasible title to the instrument. But, if he takes a cheque bearing a not negotiable crossing, he has no better title to the instrument than his transferor has. So, if A draws a cheque in favour of B and places upon it a not negotiable crossing, and B indorses the cheque, and the cheque is subsequently stolen by C, who persuades D to cash the cheque, then, notwithstanding that D may have taken the cheque in good faith, and for value, without knowledge that C was a wrongful holder, he has no better right to enforce payment of the cheque than C has, and that is no right at all. Had the cheque not borne a not negotiable crossing, D, in the same circumstances, would have been holder in due course of the cheque; entitled to enforce payment of it both against B and A. No sound business man would change a not negotiable cheque for a stranger. Indeed, it is not the practice of sound business men to negotiate cheques at all. The practice is to pay them into the bank as quickly as possible for collection. But cheques are not uncommonly negotiated by private persons.

Forged Cheques.—It is said that a banker is bound to know his customer's signature, so that if a customer's signature to a cheque is forged, and the banker pays it, he cannot debit the customer's account with the payment. But the real ground of the banker's liability when he pays a cheque bearing a forged signature is that he has paid away his customer's money without authority to do so, on an instrument that is not a cheque, but a mere piece of paper. S. 24 of the Act, quoted on p. 771, defines the banker's liability if he pays a bill or cheque containing a forged signature. The only case where a banker may be entitled to debit his customer with payment of a cheque bearing the forged signature of the drawer is where the customer is estopped or precluded from setting up the forgery, because by his conduct he has misled the banker, or induced him to believe the signature to be genuine, or has not repudiated the forged signature as soon as it has come to his notice.

Fraudulent Raising of Amount of Cheque.—A customer is bound to exercise reasonable care in drawing cheques to prevent the banker from being misled, and if he does exercise reasonable care, and nevertheless the cheque is fraudulently raised in amount, and the banker pays it, the banker cannot debit the customer with any greater sum than that for which the cheque was originally drawn. But where the customer negligently though innocently draws a cheque in such a manner as to facilitate fraud, e.g. where he leaves blank spaces or affords other opportunities for increasing the amount of a cheque, he

is guilty of a breach of duty to the banker, and is responsible to him for any loss that is the natural and direct consequence of his breach of duty (*London Joint Stock Bank v. Macmillan and Arthur*, [1918]). But the banker himself may be precluded from setting up the breach of duty against the customer in cases where, by the exercise of reasonable care, he could have detected the fact that the cheque had been tampered with.

Forged Indorsement.—A banker's duty with regard to indorsements on cheques is to see that they are correct as to form. If he pays a cheque, an indorsement whereon is irregular, he is liable to the true owner of the cheque should the indorsement be forged or unauthorised. But the paying banker, although he may satisfy himself that the indorsements are correct as to form, is not in a position to know whether the signatures are authentic. Accordingly, the Act affords him protection. By S. 60, where a cheque bears a forged or unauthorised indorsement, and the banker pays it in good faith and in the ordinary course of business, he is deemed to have paid the cheque in due course, although such indorsement has been forged or made without authority. S. 60 applies only to cheques, not to other bills of exchange, and only to cheques payable to order, whether crossed or uncrossed. A cheque originally drawn payable to bearer need not be indorsed, and if any indorsements appear thereon the banker may ignore them.

Payment of Crossed Cheques.—By S. 79, where a cheque is crossed specially to more than one banker, except when crossed to an agent for collection being a banker, the banker on whom it is drawn shall refuse payment thereof. If a banker pays a cheque so crossed, or if he pays a cheque crossed generally to any one but a banker, or if he pays a cheque crossed specially to any but the banker named, he is liable to the true owner of the cheque for any loss the true owner may sustain owing to the cheque having been so paid. Unless a banker pays a cheque strictly in accordance with the crossing, he is guilty of negligence and cannot debit his customer's account with the payment.

But protection is afforded to the paying banker by S. 80, which says that if a banker on whom a crossed cheque is drawn pays it in good faith and without negligence to a banker, if the cheque is crossed generally, and to the banker named, or his agent for collection being a banker, if it is crossed specially, then the banker paying the cheque, and, if the cheque has come into the hands of the payee, the drawer, shall respectively be entitled to the same rights and be placed in the same position as if payment had been made to the true owner of the cheque.

Collection of Cheques.—The five paragraphs above deal with the perils that confront the banker paying cheques, and the statutory protection afforded to him, in certain circumstances, by SS. 60 and 80 of the Act. The collecting banker, i.e. the banker who receives

payment, has also to face certain risks; and is also, in certain circumstances, afforded statutory protection.

In general, the position of a banker who collects a cheque for his customer depends upon the customer's title to the cheque. A banker who collects an uncrossed cheque for a customer, to which the customer has a defective title, or on which there is a forged indorsement, is entirely without protection, and is liable to the true owner of the cheque for conversion or for money had and received to his use, and the banker can look only to his customer for indemnity. By " conversion " is meant the " wrongful intermeddling with the goods of another for the purpose of taking them away from the party entitled to them " (Hart, *Law of Banking*, 3rd edn., p. 545). But if the banker be holder for value of an uncrossed cheque, or of a crossed cheque that is not marked " not negotiable," as, e.g., where he credits the cheque to his customer as cash, and by definite agreement expressed or implied allows him to draw against the cheque before clearance, then, in the case of defective or no title in the customer, he is holder of the cheque for value with a good title to sue all parties to the cheque ; and, in the case of forged indorsement, though he is liable to the true owner of the cheque, he has rights against indorsers subsequent to the forgery, if any there be.

The protection afforded to the banker collecting crossed cheques is contained in S. 82 of the Act. That section says where a banker in good faith and without negligence receives payment for a customer of a cheque crossed generally or specially to himself, and the customer has no title or a defective title thereto, the banker shall not incur any liability to the true owner of the cheque by reason only of having received such payment. By the *Bills of Exchange (Crossed Cheques) Act*, 1906, a banker receives payment of a crossed cheque for a customer within the meaning of S. 82, notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof.

It is to be observed that the banker must not only receive payment in good faith and without negligence, e.g. he must see that the indorsements purport to be correct and in order, but the cheque must be collected for a customer. The term " Customer " is not defined in the Act, but it seems to be essential that to be a customer of a bank one must have some sort of account with the bank and that a casual service performed by a banker for a person, e.g. where a banker cashes a cheque for a person introduced by a customer of the bank, does not make that person a customer.

Non-Transferable Cheque.—Every cheque is negotiable that does not contain words prohibiting transfer, or indicating an intention that it shall not be transferable (S. 8 [1]). To make a cheque non-transferable, it must be drawn in such a way as to leave no doubt of the drawer's intention. The words " order " or " bearer " should be

deleted; the payee should be named restrictively, e.g. "Pay James Brown only"; and the words "not transferable" should be plainly written across the face of the cheque. A non-transferable cheque is a mere mandate for the payment of money to a named payee, and the negation of a negotiable instrument. It must not, as it sometimes is, be confused with a cheque marked "not negotiable."

Alterations on Cheque.—Every material alteration on a cheque requires to be attested by the drawer's full signature or his initials appended to the alteration. Thus where the date or amount is altered, or the word "order" is changed to "bearer," etc., the drawer must add his initials or his signature to the alteration in order to authenticate the alteration.

Marked Cheque.—Bankers sometimes place their initials upon cheques, and by so doing certify them as good for payment. This marking may be done at the request of the drawer, or of the banker collecting the cheque. If a cheque is marked at the drawer's request, the banker is entitled to retain in hand sufficient funds to pay the cheque, and to dishonour other cheques of the drawer, if payment of these cheques would reduce the customer's balance below the amount required to meet the marked cheque; and the drawer cannot countermand payment of the cheque, which, by the marking, has been constructively paid. Marking at the customer's request is not encouraged by bankers. They prefer to give their own draft in exchange for the cheque.

Marking at the request of the collecting banker is a recognised banking practice. When a cheque is received too late in the day for presentation through the Clearing House, it is taken, where circumstances make that course desirable, direct to the drawee banker, who, if he holds sufficient funds of the drawer, marks it as good for payment next day. In this case the marking constitutes a complete appropriation of funds in the hands of the paying banker to the collecting banker in the ordinary course of business, and amounts to constructive payment of the cheque. Such marking precludes the customer countermanding payment of the cheque.

Stale Cheques.—The word "stale" in connection with cheques may have reference to the negotiability of the cheque, or to the banker's duty to pay the cheque on presentation. From the point of view of negotiability, a cheque, in the absence of special circumstances, would be regarded as stale, i.e. as having been in circulation for an unreasonable length of time, after the lapse of about ten days from the date of issue. A person who takes a cheque that has been in circulation for an unreasonable time may be considered to have taken it with notice of any defect in the title to the cheque of the person from whom he took it, and, therefore, in the event of a defective title in his transferor, be debarred from recovering the amount from prior parties to the cheque. As regards payment, banking practice differs. One banker

might consider a cheque to be stale, and require the drawer's confirmation before he paid it, if it had been outstanding for six months from its date. Another banker might pay a cheque that had been outstanding for twelve months. Here, as in other connections, the banker would have regard to the special circumstances of the case.

Post-Dated Cheques.—A post-dated cheque is a cheque that bears a date posterior to the date of its issue. It is perfectly valid for purposes of negotiation, but if a banker pays such a cheque before its due date, he loses his statutory protection as paying banker, and must bear any loss that results from his having so paid. Indeed, it is doubtful if he can in any circumstances debit such a payment to his customer if the customer objects. Further, if having paid a post-dated cheque before its due date, the banker were to dishonour other cheques not post-dated, because by payment of the post-dated cheque the customer's balance had been depleted, he would be liable to his customer for damage to credit.

Statute of Limitations.—All contracts by bill of exchange are simple contracts, and the drawer, acceptor, and indorsers of a bill, or the drawer and indorsers of a cheque, or the maker and indorsers of a promissory note remain liable upon the instrument for its amount for a period of six years, after which time all claims are barred by the *Statute of Limitations*. But this Statute does not apply to bank notes, the issuers of which are liable upon them no matter how long they have been in circulation. In the case of a cheque, if the drawer suffers loss through the holder's delay in presenting the cheque; if, e.g., the holder held the cheque for an unreasonable time, and the banker failed before the cheque was presented for payment, and the drawer was creditor of the banker for a larger sum by the amount of the cheque than he would have been had the cheque been presented and paid, then the holder could not recover from the drawer, but must claim against the banker's estate. A claim may be taken out of the Statute, if the debtor acknowledges in writing the existence of the debt, and signs the acknowledgment either by his own hand or that of his duly authorised agent; or if he makes payment on account of the debt.

III. Promissory Notes.

A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer (S. 83 [1]).

An instrument in the form of a note payable to the maker's order is not a note unless and until it is indorsed by the maker (S. 83 [2]).

A note may contain a pledge of collateral security, and, in case of default by the maker, confer authority to sell or dispose of the security deposited by the maker (S. 83 [3]). As in the case of a bill, the sum

for which a note is made may be payable by instalments, or with interest, etc.

A note which is, or on the face of it purports to be, both made and payable within the British Islands is an inland note. Any other note is a foreign note (S. 83 [4]).

No precise form is laid down for a note. So long as in form it satisfied the above definition it is valid.

The following is a common form of note :—

> **£100.** LONDON, 8 JOHN STREET, W.C. 1.
> *January* 15, 19...
>
> 1s.
>
> On demand I promise to pay to Mr. George Watson the sum of One Hundred Pounds value received.
>
> SOAMES WALKER.

Whereas to a bill of exchange and a cheque there are primarily three parties, to a note there are primarily two, viz. the maker and the payee. The maker of a note corresponds to the acceptor of a bill, and the first indorser of a note to the drawer of an accepted bill payable to drawer's order (S. 89 [2]). The maker of a note is the person primarily liable thereon ; the drawer of a bill is liable thereon only if it has been negotiated, and the drawee does not accept or pay the bill.

The maker of a note engages that he will pay it according to its tenor, and is precluded from denying to a holder in due course the existence of the payee and his then capacity to indorse (S. 88).

The law as to bills of exchange applies with the necessary modifications to promissory notes (S. 89 [1]). The provisions as to presentment for acceptance, acceptance, acceptance *suprà* protest, bills in a set, do not apply to promissory notes, and where a foreign note is dishonoured protest is unnecessary (S. 89 [3]).

Joint and Several Notes.—Where a bill is accepted by two or more persons who are not partners, the acceptors are jointly liable thereon, and, in case of default, all should be sued, for if one only is sued, and judgment is obtained but is not satisfied, no action can lie against the other acceptors. But if a note is made by two or more makers, the makers may be jointly liable or jointly and severally liable. If the liability of the makers is joint and several, one maker may be sued alone, and if the judgment obtained against him is unsatisfied, the other maker or makers may each be severally proceeded against in turn, until judgment is fully satisfied ; or, alternatively, all the makers may be sued together. It depends upon the form of the note whether the liability of the makers is joint, or joint and several. If a note reads "We promise to pay" and is signed by two or more makers, the liability is joint; if a note reads "I promise to pay," and it is signed by two or more makers, the liability of the makers is joint and several.

If a note is in the body of it made payable at a particular place, it must be presented for payment at that place in order to render the maker liable. In any other case no presentment for payment is necessary in order to render the maker liable. Presentment for payment is necessary to make an indorser liable; and if a note is in the body of it made payable at a particular place, the note must be presented for payment at that place. Where a place of payment is mentioned, not in the body of the note, but by way of memorandum only, presentment at that place will make an indorser liable, but a presentment to the maker elsewhere will also make him liable (S. 87). If a note is dishonoured, due notice of dishonour must be given to an indorser. Presentment for payment of a note may be excused on the same grounds as presentment for payment of a bill is excused.

A note payable on demand that has been indorsed must be presented for payment within a reasonable time of the indorsement, otherwise the indorser is discharged. A note payable on demand that has been negotiated is not deemed to be overdue so as to affect the holder with defects of title of which he had no notice, because a reasonable time for presenting it for payment has elapsed since its issue (S. 86). Notes are frequently made with the intention that they shall form a continuing security. Hence this difference in the law between bills and notes.

Stamping Notes.—The scale for stamping is given on p. 761. It is to be noted that a bill payable on demand is stamped 2d. for any amount; a note payable on demand is stamped *ad valorem.*

Bank Note.—A bank note is a promissory note made and issued by a banker payable to bearer on demand. Until recently bank notes could not be issued in England (though they could in Scotland and Ireland) for less than £5. *The Currency and Bank Notes Act*, 1928, however, authorised the Bank of England to issue notes of £1 and 10s. denomination, and these have since been in common use, replacing the Treasury Notes (issued by the Government), which previously served as currency.

I O U.—An I O U is an acknowledgment of indebtedness for a stated sum signed by the giver, who may be sued at any time thereon for a period of six years from its date. If the I O U contains, besides the mere acknowledgment of indebtedness, a promise to pay, it may constitute a promissory note.

EXAMINATION QUESTIONS.

1. What are the characteristics of a negotiable instrument? Give examples of such instruments. Is a bill of lading a negotiable instrument?

2. Explain the uses in commerce of the bill of exchange.

3. Give the legal definition of a bill of exchange and comment upon the several clauses of the definition.

4. Give the stamp duty on the following: (*a*) Inland bill drawn at 3 d/s for £850; (*b*) Inland bill drawn at 90 d/d for £535; (*c*) Foreign bill drawn at 3 m/d for £929, payable in Berlin, indorsed in London; (*d*) Promissory Note for £1,000 payable on demand.

5. Why is a bill drawn after sight or date presented for acceptance? Show alternative forms of acceptance by Stuart & Co., the drawees of a bill. What is a general and what a qualified acceptance? If C. Seed, the holder of a bill, takes a qualified acceptance on a bill that has been negotiated several times, what must he do in order to bind the indorsers?

6. Give the rules as to presentment for acceptance of a bill; also the rules as to presentment for payment.

7. What are days of grace? Give the due dates of the following bills: (*a*) bill dated June 30 payable at 1 m/d; (*b*) bill dated December 31 payable at 3 m/d.

8. In what ways may a bill be dishonoured? What must the holder of a dishonoured bill do before he can take action on the bill?

9. State what you know as to the giving of notice when a bill has been dishonoured.

10. Of what does noting and protesting a bill consist? Is it necessary to note a dishonoured inland bill, or to protest it; if so, when?

11. What is a case of need? Explain acceptance for honour *suprà* protest, and payment for honour *suprà* protest.

12. The damages upon dishonour by non-payment of a bill are liquidated damages. Explain this, and the extent of the damages recoverable.

13. Define, respectively, the liability of (*a*) the acceptor, (*b*) the drawer, and (*c*) an indorser of a bill. What is the drawer's remedy against the drawee of a bill dishonoured by non-acceptance?

14. Differentiate between a holder and a holder in due course of a bill, and simply explain the difference by an illustration.

15. What do you understand by the negotiation of a bill? A bill is made payable to A.B. How is it negotiated? Explain the terms "indorsement in blank," "special indorsement," and "restrictive indorsement."

16. Explain the law of agency in connection with the drawing, acceptance, and negotiation of bills. What is the effect of indorsing a bill "sans recours," and when is it done?

17. Mention the five ways in which a bill of exchange may be discharged.

18. What is an accommodation party, and an accommodation bill? A bill is paid by an acceptor who has accommodated the drawer of the bill. Is the bill discharged by the payment?

19. Wherein does a cheque differ from a bill of exchange?

20. Illustrate two general crossings of a cheque and two special crossings. What is the effect of adding to a crossing the words "not negotiable"?

21. A customer adds to the crossing of a cheque the words "Payee's Account only." Discuss this addition from the point of view of the drawee banker.

22. Drawer's signature to a cheque is forged and the cheque is paid by the banker. Can the banker debit the payment to the drawer; if so, when?

23. A customer negligently draws a cheque. It is fraudulently raised in amount by the payee, and the banker pays the increased amount. Discuss the banker's position (*a*) if the alteration were apparent; (*b*) if it were not apparent.

24. What is the banker's duty as regards the payment of crossed cheques? State the measure of the protection afforded to the banker paying a crossed cheque by S. 80 of the *Bills of Exchange Act*.

25. A banker collects a crossed cheque for a customer who has a defective title to the cheque. In what circumstance is the banker protected in so doing? Supposing the cheque were uncrossed, what then is the banker's position?

26. What is a non-transferable cheque, and what is a marked cheque ?

27. Discuss the question of stale cheques from the point of view (*a*) of payment ; (*b*) of negotiability.

28. Define a promissory note. What is a joint note, and a joint and several note ?

29. A banker pays a post-dated cheque, and subsequently dishonours cheques not post-dated. Discuss the banker's position.

30. Define a banknote. What is an I O U, and when may it amount to a promissory note ?

31. Explain the phrase "exchange as per indorsement," and also what is meant by "re-exchange."

Chapter XXII

BANKING. FOREIGN EXCHANGE

I. Banking

The original bankers in this country were the London goldsmiths, who, since they possessed the necessary accommodation of strong rooms, combined with their craft and its adjuncts money changing and money lending, the reception for safe custody of the money and other valuables of their customers, issuing therefor accountable receipts, undertaking to restore on demand the property deposited. In this last function they acted as bailees, except that, so far as loose money was concerned, they refunded not the actual coins deposited but their equivalent. Coins have no earmark. These accountable receipts were the forerunners of the bank note, the change from a receipt made out in the name of a particular depositor to a document promising to pay on demand a definite sum to bearer being both easy to make and in the obvious line of development.

Apart from the profit earned by the goldsmith-bankers by loaning their own money, they soon found that a proportion of this money deposited with them by their customers always remained in their hands, and that they could safely lend at interest against this nucleus of deposits to persons desirous of borrowing from them, provided that they did not lend in excess, or for too long periods, and were careful to whom they lent. They did this by issuing to borrowers their own promissory notes payable on demand; and, in so doing, they made a further discovery, viz. that, since a proportion of their issued notes always remained in circulation, a given amount of money held in their vaults could support the issue of a considerably larger amount of notes. Accountable receipts could be issued only to the extent of covering the actual money or other valuables deposited; the issue of pieces of paper promising to pay definite sums of money on demand was unconditioned, except by the willingness of the public to accept these legal acknowledgments of indebtedness in lieu of actual cash, and the issuer's business acumen, prudence, and honesty in gauging the extent to which he could issue them, so as always to be able to discharge in cash on demand the varying proportion presented for payment.

Thus were evolved the foundation principles of modern banking :—

(a) The mobilisation of capital, and its temporary transfer under

interest from those who have no immediate use for it to those who can employ it profitably in trade or industry.

(*b*) The creation of the thing called " banking credit " by means of its appropriate instruments, the promissory note, the bill of exchange, and the cheque.

In point of time, banking credit created by the issue of notes preceded banking credit erected upon deposits operated upon by cheque, the latter form of credit requiring for its safe conduct a much higher degree of commercial and banking development, and wider banking experience than was required for the safe conduct of a note issue. The modern system of deposit banking was initiated in the later decades of the eighteenth century by the London private bankers, who found it difficult to circulate their notes in face of the powerful competition of the Bank of England. Deposit banking received great stimulus by the passing of the *Bank of England Act*, 1833, which authorised the establishment in London of joint stock banks, but without the right to issue notes. The activities of these early London joint stock banks were therefore confined to deposit banking.

The greater the volume of deposits, the larger was the fluctuating nucleus of deposits against which the bankers could lend. Hence, quite early, they proceeded to attract deposits by paying interest on them, the difference between the interest paid and the interest charged constituting the main source of their profits.

Prior to the foundation of the Bank of England, banking was entirely in the hands of private firms. The Bank of England was established by an Act of Parliament passed in the year 1694, and, under the power conferred by that Act, was subsequently incorporated by Royal Charter under the style of *The Governor and Company of the Bank of England*. The liability of the members was limited to the amount of their subscriptions to the capital fund. The instability of public credit had long pointed to the necessity of establishing in England a powerful bank on the Continental model. But the immediate occasion of the Bank's foundation lay in the financial necessities of the Government of William and Mary ; and its precise form differed from that of the Continental State Banks. The Bank's Charter was granted in return for a loan to the State, at 8 % interest, of the whole of its initial capital of £1,200,000. In 1696, a monopoly of joint stock banking in the United Kingdom was conferred upon the Bank.

From the foundation of the Bank, right down to the passing of the *Bank of England Act*, 1833, the maintenance of the Bank's exceptional position impeded banking development in England, and encouraged the formation of weak private banks of issue, with consequent extremely numerous banking failures and recurring financial crises. Similar effects attended the inauguration of Banking in Ireland—the Bank of Ireland was established by Royal Charter in 1783. But, in Scotland, the monopoly of Joint Stock banking conferred

upon the Bank of Scotland, established by Royal Charter in 1695, was withdrawn in 1715. In 1727, the Royal Bank of Scotland, and, in 1746, the British Linen Company's Bank were founded—both by Royal Charter. Banking in Scotland had, therefore, a much freer course than it had in England.

The Bank of England is, and always has been, a private institution. But its great resources (by the year 1816 its capital had grown to its present amount, £14,553,000); its privileges; and its close connection with the State as its banker, agent, and creditor, gave it a position and prestige that no other bank in the United Kingdom could challenge, and so gradually led to its voluntary assumption of responsibilities for the maintenance of the national credit such as, in other countries, are borne by Central State Banks. For long years now the Bank has been less concerned with earning the highest possible dividends for its stock holders than it has for the well-being of public credit. It is the pivot of our British banking system, and plays the same part in our monetary economy as do the State banks of other countries.

In 1708, an Act was passed forbidding any banking corporation other than the Bank of England, or partnership of more than six persons, to issue, in England, notes payable on demand.

The rigour of the Act of 1708 was relaxed by the *County Bankers Act*, 1826. Under that Act, banking corporations, or banking partnerships exceeding six persons, could be formed in England so as to issue notes payable on demand, provided that they had no office in London, and no places of business within sixty-five miles of London, and their notes were payable at a place or places specified thereon exceeding sixty-five miles from London. The same Act authorised the Bank of England to open branches in any place or places in England. [The Bank has opened a few branches, but the great development of branch banking has been effected by joint stock banks, other than the Bank of England, and in much more recent times.]

The *Bank Notes Act*, 1828, authorised the issue in England (except within the City of London or within three miles thereof) of bank notes on unstamped paper. Bankers in England were authorised to issue bank notes for sums of £5 or over payable to bearer on demand, on unstamped paper, provided that they had obtained a licence so to do, and had given security by bond for the stamp duty.

By the *Bank Notes (No. 2) Act*, 1828, no bank in England could issue notes payable to bearer on demand for less than £5.

The *Bank of England Act*, 1833, authorised the formation of banking corporations, or partnerships exceeding six persons, in London or within sixty-five miles of London, but not so as to issue in England notes payable to bearer on demand. The same Act constituted the notes of the Bank of England a legal tender in England and Wales for all sums above £5, except by the Bank and its branches. [Bank of England notes are not legal tender in Scotland and N. Ireland; notes issued by Scots and North Irish bankers are not legal tender anywhere.]

The *Bank Charter Act*, 1844, forbade the establishment in the United Kingdom of any new bank of issue, and, in England and Wales, restricted the issue of bank notes payable on demand to those bankers who were lawfully issuing such notes on May 6, 1844. But no banker was to have in circulation a greater monthly average amount of notes than the average amount that

he had in circulation computed over the twelve weeks preceding the 27th day of April, 1844. [Existing Scots and N. Irish banks of issue are allowed to issue in excess of this maximum provided that the excess issue is covered pound for pound by Bank of England notes.]

As regards the Bank of England itself, its business was to be divided into two distinct departments: (*a*) the Issue Department, (*b*) the Banking Department, and an account for each department—the Bank Return—made out in the form set out in Schedule A annexed to the Act, was to be rendered every week to the Commissioners of Stamps and Taxes [now merged in the Board of Inland Revenue]. The Issue Department was to assume the liability for all the Bank's notes then issued, and against this liability was to be set the sum of £11,015,100, being the Government's debt due to the Bank, and a further sum in securities of £2,984,900. Thus, at that date, the Bank's issue of notes against securities—therefore termed the *fiduciary issue*—amounted to £14,000,000. All notes issued in excess of that amount were to be secured pound for pound by gold and silver held in the Issue Department, but the silver held was not to exceed one-fourth part of the gold.

It was also provided that if any banker in the United Kingdom entitled to issue notes payable on demand should cease to carry on the business of banking, or discontinue the issue of notes either by agreement with the Bank of England or otherwise, he could not thereafter issue notes, and the Bank could, by authorisation, increase its fiduciary issue of notes to the extent of two-thirds of any note issue that should lapse. Under this provision, the Bank increased its fiduciary issue by £5,750,000 to its maximum of £19,750,000.

The *Bank Charter Act* was designed to prevent the recurring monetary crises that had convulsed the country in the past, and to ensure the convertibility of the note. But it failed in both respects, and has been much criticised on that account. Criticism of the Act has, however, been silenced by the course of events. Its failure was largely due to lack of experience and insight in discriminating between banking credit based on the issue of notes and banking credit erected upon deposits operated upon by cheque. Already, in 1844, the former sort of credit was meeting formidable competition from the latter; and it may be said with truth that, throughout the greater part of the nineteenth century, the whole banking world was at school learning painfully by experience how to handle the new credit instrument, so as to afford the maximum of benefit to industry and trade with the minimum of risk to itself. By the year 1890 the necessary degree of banking experience and organisation had been fully attained. In that year the failure of the great house of Baring Brothers was prevented from precipitating a financial panic of the first magnitude by the patriotic behaviour of the Bank of England, and the financial skill of its then Governor, Mr. Lidderdale, in association with the directorates of our large joint stock banks.

By the *Joint Stock Companies Act*, 1857, the number of persons who could unite to form a banking partnership was increased from six to ten, but cannot exceed ten. This provision is re-enacted in S. 358 of the *Companies Act*, 1929.

The Act of 1833 had widespread consequences. Under that Act, banking corporations, or partnerships of more than six persons, could be formed in London. The first to be formed was the London and Westminster Bank in 1834, and it was quickly followed by others. These were not corporations as we understand the term to-day. They were common law partnerships with unlimited liability, who sued or were sued through two or more of their members appointed in their

Deeds of Settlement as public officers of the corporation. Limited liability secured by registration was impossible until 1855, and it was not until 1858 that the privilege was extended to banking corporations. Even so, no bank of issue to-day in Great Britain or Northern Ireland enjoys limited liability in respect of its note issue.

Long before 1833, the London private bankers, yielding to the powerful competition of the Bank of England, had ceased to issue notes, and had developed the modern system of deposit banking and withdrawal by cheque; and by the year 1775, the London Clearing House had grown from its first informal beginning into an established institution.

The London private bankers, and also the Bank of England, turned a cold shoulder to the new joint stock banks, and for some years these banks occupied a somewhat anomalous position. But the future lay with them, and when they had so far established their position that they could no longer be excluded from membership of that somewhat exclusive institution, the London Clearing House (they were admitted in 1854), banking entered upon its penultimate stage of development.

The pre-condition of the establishment and growth of a banking system is, of course, the inauguration and steady expansion of industry and trade. The course of British banking has been traced briefly, beginning with

(*a*) Bailment, its characteristic instrument being the accountable receipt;

(*b*) Deposit banking and the creation of banking credit by the issue of notes;

(*c*) The founding of the Bank of England;

(*d*) The multiplication throughout the country of private banks of issue;

(*e*) The development by the London private bankers of deposit banking operated upon by cheque, and of banking credit erected upon deposits, the characteristic instruments being the cheque and the bill of exchange.

(*f*) The establishment of a Clearing System, i.e. a method of settling the mutual daily indebtedness between banker and banker, as evidenced by the note, the cheque, and the bill of exchange, by set off, and payment by one to the other of the daily balances in one sum; and, later, by a simple transfer in the books of the Bank of England, with which institution all clearing bankers keep an account;

(*g*) The accession to the ranks of the London private bankers of the early joint stock banks;

(*h*) The passing of the *Bank Charter Act of* 1844.

The rest of the story may be compressed as follows:—

(*a*) By operation of the Act of 1844 note issues have gradually

been suppressed until now the only bank of issue in England and Wales is the Bank of England.

(*b*) The Clearing House System, keeping pace with banking growth, has been perfected and extended to the large provincial towns. The London Clearing House now comprises three sections: Town, Metropolitan, and Country Clearing. In 1928 the bills, cheques, etc., passing through the Town Clearing totalled £39,311,117,000; the total for the Metropolitan Clearing was £1,854,435,000; the total for the Country Clearing, £3,039,422,000: an aggregate of £44,204,974,000. The provincial Clearing Houses are concerned with the collection of local cheques only, and Scotland and Northern Ireland have independent clearing systems.

(*c*) By amalgamation with, and absorption by, the large joint stock banks, and from other causes, e.g. failure, and registration with limited liability, the private banks have been gradually reduced in number almost to the point of extinction. For that reason, and because of the growth of the habit of banking, not only amongst the trading community but also amongst the general public, the deposits of the joint stock banks have reached enormous proportions. Even by the close of the nineteenth century the resources of some of these banks overshadowed those of the Bank of England itself. The Bank of England has always, as a rule, refused to pay interest on deposits, and has therefore offered no inducement to the great mass of the public to open accounts with the Bank.

(*d*) Following the general trend of capitalistic enterprise everywhere to form larger and larger aggregates, joint stock banks themselves have amalgamated. The net result is that the whole commercial banking system of Great Britain and Northern Ireland is now in the hands of a few large joint stock banks, chief amongst which, omitting the Bank of England, are the following five great institutions with their affiliated banks in Scotland and Northern Ireland, and their thousands of branches throughout the country: The Midland Bank, Ltd.; The Westminster Bank, Ltd.; The National Provincial Bank, Ltd.; Lloyds Bank, Ltd.; Barclays Bank, Ltd. Other large English banks are: Martins Bank, Ltd.; Baring Brothers & Co., Ltd.; Glyn, Mills & Co. (private company); Hambros Bank, Ltd.; District Bank, Ltd.; Lancashire and Yorkshire Bank, Ltd.; Manchester and County Bank, Ltd.; National Bank, Ltd.; Williams Deacon's Bank, Ltd. Besides these banks there are the three great Discount Houses, which also accept deposits, viz. National Discount Co., Ltd.; Union Discount Co. of London, Ltd., and Alexander's Discount Co., Ltd.; and the great financial houses such as N. M. Rothschild & Sons; Frederick Huth & Co.; Kleinwort, Sons & Co.; Samuel Montagu & Co.; etc. Then there are the great unaffiliated Scots banks: Bank of Scotland; Royal Bank of Scotland; Commercial Bank of Scotland,

Ltd.; North of Scotland Bank, Ltd.; and the Union Bank of Scotland, Ltd.; and one unaffiliated Ulster bank, the Northern Banking Co., Ltd.

(*e*) In addition to the banks enumerated above there are the London offices of the foreign banks, of the self-governing Dominions, and of the British banks operating in the Dependencies, the Colonies, and elsewhere. The Dominion and foreign banks conduct their businesses for the benefit of their own peoples, and are therefore outside the British banking system, although linked with it in the course of trade, and, so far at least as the Dominion banks are concerned, by community of interest.

(*f*) Prior to the Great War foreign banking was mainly in the hands of foreign banks operating through their London offices. To-day a large and growing proportion of the foreign exchange business arising from our international trade is transacted by our British Banks operating through their foreign subsidiaries or correspondents. Thus much of the profit derived from this source, which formerly passed to foreign banks, is now secured by our own banks, and by other British financial houses engaged in foreign exchange business.

Functions of a Banker.

There is no statutory definition of the term "banker." Clearly, a banker is one who carries on the business of banking, and by the *Bills of Exchange Act*, 1882 (S. 2), the word "banker" includes a body of persons whether incorporated or not who carry on that business. But what is banking business? The one feature that distinguishes banking in this country from all other business is the receipt of money on current account and its repayment by cheque. So Dr. Heber Hart defines a banker as "one who, in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives moneys on current accounts." This is a descriptive, not a legal, definition, and it is confined to one only of a banker's functions, albeit the chief and distinguishing function.

In the varied functions that a banker may perform for his customers he may act sometimes as a principal and sometimes as an agent. These functions may be enumerated as follows :—

(1) To receive money on current account repayable on demand, and/or on deposit account repayable with interest after due notice given. In this connection the banker is a borrower and debtor to his customer to the extent of the customer's credit balance on current account, and/or on deposit account.

The money received by a banker from his customer may be in the form of legal tender, or it may come to him in the shape of cheques of which the customer is payee, or holder in due course; or of bills of which the customer is drawer, or payee, or holder in due course;

or of promissory notes of which the customer is payee or holder in due course; or in the form of dividend warrants, interest coupons, etc. These instruments representing money must then be presented for payment to the bankers, or other persons on whom they are drawn, or by whom they are payable, and the proceeds of collection be credited to the customer's current account. In this capacity of collecting banker for his customer, the banker is, in general, his customer's agent, bound to exercise due diligence in safeguarding his customer's interests. But a banker may incur liability to the true owner of the instruments collected for a customer in certain cases where the customer is not the true owner of them, and the banker is unable to claim statutory protection for his acts (*see* p. 781).

Repayment consists in honouring the cheques drawn upon him by his customers and, if so instructed, in paying bills of exchange which the customers have accepted, or promissory notes they have made, and in paying dividend warrants, coupons, or other orders for payment which they may have issued. In the capacity of paying banker the banker is also his customer's agent. The customer is the mandant giving certain orders for payment, and the banker is the mandatory, bound to carry out those orders promptly and with exactitude, so long as they are issued in legal form; and are authenticated by the customer's signature, or by the signature of his duly authorised agent; and are free from ambiguity; and so long as he is debtor to his customer, whether actually or by agreement, as, e.g., when he has lent money to his customer either by way of loan or overdraft.

(2) To lend money to his customers, (*a*) on loan account, or (*b*) by way of overdraft. Usually a banker lends against security given by the customer, or by a third party on the customer's behalf, and always at interest. In this capacity the banker acts as a principal, and is the creditor of his customer till the loan is paid off, or the current account is again in credit.

(3) To discount Bills of Exchange and Promissory Notes for his customers. This is similar, in practice, to lending at interest against security; although quite different in principle.

(4) To issue Drafts, Mail Transfers, Telegraphic Transfers, Travellers' Letters of Credit, Circular Notes, Travellers' Cheques, etc. Here the banker acts as a principal, selling his own unimpeachable credit instruments against his customers' cash. Under this head the issue of bank notes may be included. In England and Wales the issue of bank notes is now confined to the Bank of England. But there are several Scots and N. Irish banks with important note issues.

Bankers and financial houses in this country have banker correspondents in all the large towns throughout the world, and some of them have subsidiaries, or branches in Continental capitals, and in the capitals and large towns of other countries in which British banks are allowed to establish branches. Similarly, the chief foreign

banks and financial houses have branches or correspondents in London and throughout the world.

A Banker's Draft is an ordinary cheque, or it may be a bill payable at some time after sight or date, drawn upon a foreign branch of the bank, or upon another banker in the foreign centre, in favour of a named payee, either against a balance kept by the drawing banker with the drawee, or against cover to be provided by the drawing banker. The cheque is handed to the purchaser, against cash or a debit to his current account, and is posted by him to the person in whose favour it is drawn. Such drafts are usually drawn in a set of two marked respectively " Original " and " Duplicate."

A Mail Transfer.—This instrument is similar to the draft, but, instead of handing a cheque or bill to the purchaser, the banker himself directs his branch or correspondent, by mail, to make the payment to the named beneficiary. The work of remittance is done entirely by the bank. The paying banker intimates to the beneficiary at the time of payment the name of the remitter, and the purpose to which the remittance is to be applied, and he obtains a receipt for the payment.

A Telegraphic Transfer (*or T.T.*).—In this case the remittance is effected by cable. The cable is in code and authenticated by a test word known only to the remitting and paying bankers.

Travellers' (*Circular*) *Letters of Credit.*—Acceptance credits are dealt with below. Travellers', or Circular, Letters of Credit are credits issued to persons who propose to travel abroad. They are addressed not to one foreign banker or correspondent, but to the issuing bank's correspondents generally in those countries which the purchaser intends to visit. A list of such correspondents is given in the letter. The credit is for a stated maximum, and authorises the correspondents to pay the bearer whatever sums he may require up to the limit, against his sight drafts drawn in sterling upon the banker issuing the credit, the drafts to bear the phrase " Drawn against L/C No. ——." Whenever the beneficiary draws such a draft, the paying banker must write particulars of it on the back of the credit, and the correspondent paying the last draft (exhausting the credit) is required to cancel the letter and attach it to the draft. The beneficiary under the credit is also provided with a *Letter of Indication*, which he ought to sign as soon as it is handed to him by the issuing banker. The paying banker requires this document to be produced to him before he pays, and he also requires the drafts drawn by the beneficiary to be signed in his presence, in agreement with the specimen signature in the letter of indication. As a precaution, the letter of indication should be carried separately from the letter of credit.

Circular Notes.—These fulfil the same functions as Travellers' Letters of Credit. In form they are similar to cheques, and are drawn upon the issuing banker in favour of the paying banker, or round sums of identical amount—£10, £15, £20, etc. The drawer's signature to

the cheques is appended in the presence of the paying banker, and by him compared with the specimen signature in the letter of indication.

Travellers' Cheques.—These are much the same as Circular Notes, but would appear to be less safe than Notes, since they already bear the drawer's signature. They are authenticated by the drawer again signing his name to the instrument in the presence of the paying banker. These cheques are commonly issued by such institutions as the Canadian Express Company, the American Express Company, and Thos. Cook & Sons, Ltd., and are coming into use by other British bankers.

All these instruments may be expressed to be payable, and be paid, in sterling, or in foreign currencies. Where they are expressed to be payable in sterling, payment is made in foreign countries, in the currency of the particular country, at the paying bankers' buying rate for sight drafts on the country of issue at the time of payment. *See* (12), p. 800.

(5) To issue Acceptance Letters of Credit. These may be in one of several forms :—

(*a*) *Clean* (*Blank*) *Credits*, i.e. credits operated upon by bills of exchange unaccompanied by shipping documents. Such credits are issued only to foreign bankers and financial firms of the highest repute.

(*b*) *Documentary Credits*, i.e. credits which require the bills of exchange drawn under them to be attached to the shipping documents—Bill of Lading, Invoice (Consular or ordinary), Certificate of Origin, Policy of Insurance, etc.—covering the shipments against which the bills are drawn.

These credits (*a* and *b*) are of various kinds :—

(*a*) *Confirmed Credit.*—This is a credit that cannot be cancelled except by consent of the beneficiary, i.e. the person in whose favour the credit is issued.

(*b*) *Unconfirmed Credit.*—An unconfirmed credit can be withdrawn at any time with, or even without, notice to the beneficiary.

(*c*) *Revolving Credits.*—These are continuing credits, as distinguished from an ordinary credit for a definite amount, but subject to limitations, as, e.g., that the total amount of the bills drawn under the credit, and current at one time, shall not exceed a stated maximum.

All credits are limited to a definite period of time, usually not exceeding from six to twelve months.

In granting Letters of Credit the banker, the grantor of the credit, undertakes to accept bills drawn by the grantee, the beneficiary under the credit, provided that the grantee strictly observes the conditions mentioned in the Letter. In this way the banker supports his own

customer's credit by guaranteeing payment in due course of the bills drawn under the credit, and so facilitates the negotiation of the bills at the lowest discount rates in the country of their origin. The customer undertakes to put the banker in funds on or before maturity of the bills accepted under the credit. In addition, the banker usually requires his customer to deposit security, and he charges him a small commission for his services.

(6) To advance against, to discount (to purchase), or merely to collect the documentary bills drawn by British exporters on their foreign customers, or, on behalf of foreign correspondents, to collect such bills drawn by foreign exporters on British importers.

A documentary bill may be either a D/A bill = documents to be surrendered upon acceptance of the bill, or a D/P bill = documents to be surrendered on payment of the bill. In the latter case, the drawee may, in order to secure the documents, and so the goods represented by them, before maturity of the bill, *retire the bill under rebate*, i.e. he may pay the amount of the bill less an interest allowance for the unexpired period that the bill has to run to reach maturity.

Where a banker makes an advance against such bills, or discounts (= purchases) them, he commonly takes from his customer a document known as a *Letter of Hypothecation*. This document constitutes a pledge of the documents of title, and therefore of the goods, to the banker, and authorises him amongst other things to sell the goods, if, upon due notice to him of dishonour, the customer does not repay the advance, and to apply the proceeds against the advance, leaving him free to come upon the customer for the difference, should the proceeds realised by sale of the goods, less the expenses incurred, prove less than the amount advanced to the customer.

Where a customer upon whom a documentary bill is drawn obtains an advance from the banker on the security of the documents, the banker frequently releases the documents to the customer upon the customer signing a *Trust Receipt*. By this document the customer undertakes to hold the goods and the proceeds of sale thereof in the name of, and in trust for, the banker, and to repay the advance from the proceeds of sale of the goods within a specified period of time.

(7) To act as agent for his customers in the purchase and sale of Government and Industrial Securities—stock, shares, bonds, etc. In transactions of this kind the banker is remunerated by sharing with the broker whom he employs in the purchase or sale, the brokerage chargeable on the transaction.

(8) To make periodical payments on behalf of customers in respect of their club and charitable subscriptions, insurance premiums, etc. In this connection the banker is an agent carrying out his customers' mandates.

(9) To store for safe custody the valuables of his customers, e.g. securities, plate, jewellery, etc. In this service the banker is

a bailee, and is liable to his customer if he delivers the valuables to the wrong person, or if, through his *gross* negligence, they are lost, stolen, destroyed, or fraudulently abstracted while they are in his custody.

(10) To answer enquiries addressed to him by other bankers regarding the financial standing and business integrity of his customers. In answering enquiries the banker is not required to do more than speak from his own personal knowledge of his customer; he must not disclose the state of the customer's account unless the customer expressly authorises him to do so; and he must be cautious in what he says, since an action for negligence and breach of duty may lie against him should he damage his customer's credit by his reply.

(11) Some Joint Stock banks take power to act as Executors and Trustees for their customers and others; and also as Custodian Trustees under the *Public Trustee Act*, 1906. A Custodian Trustee has the custody of the trust property but not the management of it, and has power to charge and retain or pay out of the trust property fees not exceeding those chargeable by the Public Trustee acting as Custodian Trustee.

(12) To buy or sell foreign currencies from or to his customers. In this connection the banker acts as a principal.

In London is centred the world's greatest market for foreign exchange. This is due not alone to the enormous foreign trade of this country, but also to the fact that a considerable part of the foreign trade of European and of other countries is financed by the London bankers and accepting houses, who charge a commission for this service.

The London foreign exchange market consists of two groups, viz. principals and brokers. The principals are the banks and financial houses dealing in foreign exchange, numbering in all about 120. These are the actual buyers and sellers of foreign currencies, and they are remunerated by the fractional differences between their buying and selling rates. They may buy direct from, or sell direct to, their own customers, and they may transact market deals, i.e. buy in large amounts from, or sell to, other principals. Etiquette demands that market deals shall always be transacted through brokers. But business transacted between principals on foreign trunk calls is done without the intervention of a broker.

Of brokers there are all told about forty firms. The broker cannot buy or sell on his own account. His function is to ascertain, by enquiry of the principals, and from information derived from other sources, the tendency of the market, and the rate at which business can be done in a particular currency; and when he has found the rate, and is actively dealing, he quotes the same rate both to the principals who buy and the principals who sell that particular currency. Thus he might

quote Paris 123.85—123.90, meaning that he is selling French francs on behalf of the market at 123.85 to the £ and buying that currency on behalf of the market at 123.90 to the £. The broker is not remunerated by a difference in price, but by a fixed brokerage, which, in the case of French francs, is 10s. per quarter million francs, charged by him both to seller and buyer. Only when the broker has effected a deal does he inform his principal of whom that principal has bought, or to whom he has sold, and, having done so, he steps aside, and leaves the two principals to arrange the details of delivery and settlement.

There is no single place or building in which this market is held. The offices of the principals and brokers are connected by telephone, and all business is transacted by telephone. Both principals and brokers have access also to Continental centres, New York, etc., and by means of trunk telephone calls and cable messages are kept in close touch with those exchange markets, and their requirements and tendencies.

The principals endeavour in their buying and selling to run an even book in every currency in which they deal. If, for example, a bank dealer has bought in all twenty million francs on a particular day, he endeavours to sell the same amount on the same day, and so even up his book for that currency. In practice, he usually finds himself short or long in his dealings at the close of business, and he rectifies the discrepancy next day, or as soon as possible, unless for particular reasons it is to his own interests that he should be oversold or overbought.

Foreign currencies are bought and sold for immediate delivery against sterling, or, in the case of market deals, for delivery and payment on the *value date*, which for French francs is two days from the date of sale. Transactions of this kind are transactions in *spot exchange*. But currencies are also bought and sold for payment on a future date, and such dealings are known as transactions in *forward exchange*.

Transactions in forward exchange involve dealings in spot exchange, for when a bank dealer sells forward, say $150,000 (an amount important enough to be dealt with in the forward market), for payment and delivery two months hence, he immediately buys the same amount spot. The spot purchase closes his exchange risk in the spot market, and secures to him his profit, leaving him with $150,000 for which he has paid sterling, and which will not be wanted for two months. But the dollars command a price, and the sale of them would release the sterling. If the dealer can gain a higher interest rate by holding the sterling in London than he can by holding the dollars in New York, and if he does not particularly want the dollars on his books, then he goes into the forward market and does a third *combined* deal, by which he completely covers his position. He sells the $150,000 spot, thus releasing his sterling, and buys the dollars back again for payment and delivery two months hence. This combined deal is always done

at a difference, the difference being in the buyer's favour, if the particular currency stands at a discount, and against the buyer, if it stands at a premium. The forward rate quoted to the customer allows for this difference.

The reason for forward dealing is that, when a particular currency is violently fluctuating in value, it makes foreign trade less of a speculation than it might otherwise be. If, e.g., an English buyer has to pay his foreign seller a large sum in the seller's currency, say two months hence, and the currency is an appreciating one, i.e. as time passes progressively less of the foreign currency is being given for the £, then by securing the currency now for delivery two months hence, i.e. by buying it forward for payment and delivery at the date on which it is wanted, he protects himself no matter how much the currency may appreciate. Again, suppose an English exporter to have sold a large quantity of goods priced in foreign currency, for payment two months hence, and the then rate of exchange shows him a profit of 10 % on the transaction. If the currency in question is progressively depreciating, i.e. if more and more of the foreign currency is being demanded for the £ sterling, his profit may be completely gone by the time that payment is due. By selling the currency two months forward at the time he sold the goods, he secures his profit.

Settlement of International Debts.—The mode of settlement of international debts involving foreign exchange is comparable with the manner in which bills, cheques, and other effects are settled through the Bankers' Clearing House in London.

By way of illustration, we will confine our view to two countries—France and Great Britain—since what is true of these is true all through, and refer to them as Paris and London respectively. Further, we will assume that French currency never leaves France, and British currency never leaves Great Britain. This assumption is correct in the main, for, although French bankers and exchange houses import British, and British banks and financial houses import French, currency, i.e. actual notes, for sale to persons who find it convenient to remit small sums in that form, or to carry them across the Channel for payment of travelling expenses, yet such importations are insignificant in themselves and are one-sided transactions that do not involve foreign exchange.

It must be remembered, too, that when we speak of debts we are not concerned with the manner in which those debts arise. The chief source of indebtedness is, of course, international trade, consisting of the importation, exportation, and transportation of merchandise, together with the bankers' services (which command a price) in financing the purchase and sale of the goods. But international debts arise in many other ways, and they may be debts owing by one Government to the other in respect of loans. By debts we mean every international obligation for the payment of money that arises at a particular moment of time for settlement between two countries.

In these days, large British corporations frequently operate in France (and other foreign countries) through subsidiaries, or agents. These often act in an independent capacity. They obtain the orders, arrange for their shipment and delivery, invoice the goods in francs, collect the invoices, and pay the proceeds into French banks for account of the London parent house or principal, so that heavy credits in French banks may be the property of British nationals, and merely require to be turned into sterling and brought home. The method of bringing these balances home is of the simplest. The British house or principal sells in the London exchange market, say, five million francs at the best rate obtainable, and against the buying banks' sterling cheques for their purchases (if the sale is effected piecemeal to different banks) hands over to them cheques drawn in francs on its Paris bankers. Large French corporations operate in Great Britain in a similar way, and buy francs in the Paris exchange market against their sterling balances here.

Again, British investors and speculators may buy large amounts of particular foreign currencies, and be credited in their London bankers' books with their holdings, the London banks keeping these currencies abroad for them with their foreign correspondents. Investors do this when they can earn greater interest upon foreign balances at the foreign rate than they could earn on sterling balances kept on deposit here, or on British Government Securities. From time to time, when rates are favourable, portions of these balances will be sold off. Foreign investors follow a similar course in connection with British currency.

A Paris debtor may discharge his debt to his London creditor in one of four ways.

If the debt is expressed to be payable in francs, he may :—

(1) Draw a cheque in francs on his Paris banker and remit the cheque to his creditor. The London creditor will then do one of two things :

(*a*) He will pay in the cheque to his London banker for collection and credit of proceeds in due course. The London banker will then send the cheque to his Paris branch or correspondent, who will collect the cheque in francs from the Paris drawee bank, and remit the proceeds, less expenses, in sterling, calculated at the Paris collecting bank's buying rate for sight drafts on London. The London banker will then credit his customer with the proceeds, less his own commission ; or,

(*b*) He will sell the cheque to his London banker and at once be credited with the sterling value of the cheque, calculated at the banker's buying rate for sight drafts on Paris. The London buying banker will then have the cheque collected as in (*a*) above.

An alternative to (*a*) and (*b*) is for the Paris debtor, instead of remitting the cheque to his London creditor, to pay it to the Paris branch

or agent of the bank of the London creditor for account of the creditor. The Paris branch or correspondent then advises the London bank of the credit, and that bank credits the London creditor (its customer).

(2) Pay a bill of exchange drawn upon him in francs by his London creditor. Here the procedure of collection is as in (*a*).

If the debt is expressed to be payable in sterling he may :—

(*a*) Purchase from his Paris banker a cheque or bill in sterling drawn by the Paris banker on his London House or correspondent, and send the cheque or bill to his London creditor. The creditor pays the cheque or bill into his own London banker, and that banker collects it from the London drawee banker, who, having paid the cheque or bill, debits the Paris drawing bank with the sterling payment.

(*b*) Pay a bill of exchange drawn upon him in sterling by the London creditor. Here the procedure of collection is as in (1*a*) above, except that the amount in francs that the Paris drawee will have to pay, in order to discharge the bill, will be, either the amount as indicated by the indorsement on the bill—" exchange as per indorsement "—or that amount of francs which is the equivalent of the sterling, calculated at the rate of exchange ruling on the day of payment for sight drafts on London.

Considering the matter from the point of view of this country, a London debtor may also pay his Paris creditor in one of four ways.

If the debt is expressed to be payable in francs, as it generally is, he may :—

(*a*) Purchase from his London banker a cheque for the required francs, at the London bank's selling rate for sight drafts on Paris, and post it to his Paris creditor. The London banker will draw the cheque on its Paris branch or correspondent, and, when paid, the Paris branch or correspondent will debit the payment to the London bank.

(*b*) He may pay a bill drawn upon him in francs by his Paris creditor. The Paris creditor will pay the bill into his own bank for collection and credit of proceeds. The Paris bank will send the bill to its London branch or correspondent, and when the London debtor pays in sterling the equivalent of the francs, the branch or correspondent will remit the francs to the Paris bank, less expenses.

If the debt is expressed to be payable in sterling he may :—

(*a*) Draw a cheque on his own bank in sterling and remit it to his Paris creditor. The Paris creditor will then either have the cheque collected by his own banker, or sell him the cheque. The Paris bank will remit the cheque to its London branch or correspondent, and, on collection, be credited in sterling with the amount of the cheque. Alternatively to either course, the London creditor

might pay the sterling cheque direct to the London branch or agent of the Paris bank for his Paris creditor's account.

(*b*) He may pay a sterling bill drawn upon him by his Paris creditor. The bill is paid into the Paris banker of the French creditor for collection, and is remitted by the Paris banker to his London branch or agent, who presents the bill to the drawee in London, and, when the bill is paid, remits the proceeds in francs at his rate of exchange for sight drafts on Paris.

It will be seen from the skeleton outline above that the international payments continually being made by French debtors to British creditors are, in the first place, made in the debtor's own currency, viz. francs. Similarly, payments by British debtors to French creditors are, in the first place, made in sterling. The instruments of payment, as previously mentioned, are the cheque, the mail transfer, the telegraphic transfer, and the bill of exchange. The conversion from one currency to the other, and the issue of these instruments (except where the debtor himself draws a cheque, or the creditor draws a bill) and their collection is thrown upon the banks of the two countries. The process of collection results in a continuous series of debits and credits in the books of each of the two groups of bankers. Thus every bank engaged in this work may be regarded as a member of a huge international clearing house, and the work of settlement is largely a matter of the transfer of book balances between members of the two groups.

Legal Tender.

By legal tender is meant the means of payment prescribed by law. When notes or coins constituted legal tender are offered by a debtor in discharge of his debt, the creditor is bound to accept them in satisfaction of the debt to the extent that they have been constituted legal tender. Legal tender in this country consists of (*a*) gold coins, (*b*) Bank of England notes, (*c*) Currency notes for £1 and 10s., (*d*) silver and bronze coins.

(*a*) *Gold Coins.*—The bulk of our former gold coinage, consisting of sovereigns and half-sovereigns, has long ago been surrendered by the public. Apart from the unknown amount of gold coins still kept by the public as curios, or privately hoarded, the gold stock of this country, whether in the form of coin or bullion, is in the keeping of the Bank of England as backing to its note issue. By law, gold coins, still legal tender to any amount, have no greater value in internal exchange than a Bank of England or a currency note for £1 or 10s.

(*b*) *Bank of England Notes.*—The Bank's notes for £1 and 10s. are legal tender in England, Wales, Scotland, and Northern Ireland for any amount, and by the Bank itself in payment of its notes of higher denomination. The Bank's notes for higher denominations than £1

and 10s. are legal tender for any amount in England and Wales, but not in Scotland and Northern Ireland.

The Bank is not now, however, compelled to redeem its notes in gold except as provided by the *Gold Standard Act*, 1925. By that Act, the Bank is not bound to pay any of its notes in *gold coin*, but any person can by tendering any legal currency to the Bank obtain gold in the form of bars containing approximately 400 oz. troy of fine gold at the rate of £3 17s. 10½d. per oz. standard ($\frac{11}{12}$ths fine), and export the gold. By the same Act, the provision of the *Currency and Bank Note Act*, 1914, whereby the holder of a currency note is entitled to payment of its face value in *gold coin* is abrogated, and S. 8 of the *Coinage Act*, 1870, which entitles any person to bring gold to the Mint and have it assayed, coined, and delivered to him is, except in respect of gold bullion brought to the Mint by the Bank of England, also abrogated. The net effect of the *Gold Standard Act*, 1925, is to restore our pre-war gold standard to the extent of permitting international (export and import) transactions to be settled by payment in gold, if necessary, but to prevent, for the present, the use of *gold coin* as an internal medium of exchange. This method of currency regulation is known as a *Gold Bullion Standard.* A gold bullion standard must be distinguished, on the one hand, from a gold *specie* standard, which requires for its working the free coinage of gold and the use of gold coin for internal circulation (this was the British standard before the War), and, on the other hand, from a *gold exchange standard*, as to which *see* p. 825.

No man of affairs in the great commercial centres of the world would, at this time of day, look askance at a Bank of England note, provided that he was satisfied that it was genuine and not a forgery. But although a Bank of England note is a gold certificate it would not be exchanged in a foreign centre except at a point or two less than the current rate of exchange between that centre and London, and in order to secure that, the most favourable rate, the exchange would have to be transacted with a reputable foreign banker. Bank Notes are not remitted abroad in payment of indebtedness to any great extent, but they are more commonly carried by Englishmen travelling on the Continent of Europe and used for defraying expenses, and they may be imported by foreign bankers and exchange dealers for sale, at a profit on the exchange, to persons proceeding to this country.

(*c*) *Currency Notes.*—These were issued in denominations of £1 and 10s. by the Treasury through the Bank of England, and are still legal tender in England, Wales, Scotland, and Northern Ireland, for any amount. Under the *Currency and Bank Notes Act*, 1928, currency notes issued prior to November 22, 1908, and outstanding on that date, are deemed to be Bank of England Notes, but the Bank has power, on giving three months' notice, to call in these notes on exchanging them for Bank of England notes of the same value In

course of time, currency notes will be as rarely seen as the gold coins for which they were substituted.

The amount of Bank Notes in circulation is determined by the public requirements for internal currency. In times of brisk industry and trade more internal currency is required than when industry and trade is depressed. When industry and trade is brisk a larger amount is disbursed in wages, the public spend more freely, and, in the aggregate, keep a larger reserve of currency on hand to meet contingencies than in the reverse conditions. An increased demand for currency invariably occurs at the holiday seasons of the year—Easter, Summer, and Christmas. When a branch bank is faced with an increased demand for currency it applies to its Head Office. The Head Office, if necessary, applies to the Bank of England, and pays for the extra supplies by a draft on its balance with that institution.

The Government has it in its power (*a*) by increasing the floating, i.e. the unfunded, debt to create conditions which may lead to an expansion of the note issue, and (*b*) by paying off or funding the floating debt to create conditions that may result in a contraction of the note issue; and the banks can by independently expanding or contracting their loans to customers create similar conditions leading to similar results. But within these conditions created by Governmental and banking policy, the public demand for currency is the actual determinant of the amount of Bank notes in circulation at any particular time.

(*d*) *Silver and Bronze Coins.*—These are token coins of small intrinsic value, owing their much greater value in internal exchange to the law of the land. Where in a country, as in this country prior to the substitution of Treasury Notes for gold, a standard gold coinage and a subsidiary token coinage circulates side by side, it is necessary to restrict the issue of token coins, for if the issue is unlimited, the inferior token coins will, as enunciated in *Gresham's Law*, drive out of circulation the superior standard coinage. The token coinage will have the same value in internal exchange as the standard gold coins, but a far less value in external exchange. Hence the gold coinage will be exported, or melted down and dealt with as metal, and the internal exchange work will be effected by the tokens alone (*see also* Quantity Theory of Money, p. 827). The restriction is effected by limiting the use of token coins as legal tender. In this country, silver coins are legal tender up to £2 but not beyond, and bronze coins up to the value of 1s. Silver and bronze coins are quite useless for external payments, for in the hands of foreigners they are worth little more than the market value of their metallic contents.

The Bank of England.

It was said on p. 791 that the Bank of England is the pivot of our British Banking system. The statement needs explanation. First,

then, let us consider a specimen of the weekly Bank Return, given below, and see what the various items in it mean. This Return, it must be noted, is in the revised form following upon the coming into operation of the *Currency and Bank Notes Act*, 1928. Under S. 10 of that Act, the old form of Return was authorised to be modified "to such an extent as the Treasury, with the concurrence of the Bank, may consider necessary." The changes in the form of Return were made, in part, to afford the banking and financial world a clearer indication of the country's monetary position than could be gathered from the old form of return.

BANK RETURN, JULY 31, 1929.

Issue Department.

	£		£
Notes Issued:—		Government Debt ..	11,015,100
In Circulation	371,817,795	Other Government Securities	235,213,833
In Banking Department	29,557,842	Other Securities.. ..	8,931,291
		Silver Coin	4,839,776
		Amount of Fiduciary Issue	260,000,000
		Gold Coin and Bullion	141,375,637
	£401,375,637		£401,375,637

Banking Department.

		£			£
Capital		14,553,000	Government Securities		62,256,855
Rest		3,554,029	Other Securities:—		
Public Deposits ..		11,078,094	Discounts and Advances ..	£9,951,195	
Other Deposits:—			Securities ..	24,151,272	
Bankers	£60,277,499				34,102,467
Other A/cs.	37,687,086		Notes		29,557,842
		97,964,585	Gold and Silver Coin		1,234,607
Seven-day and other Bills		2,063			
		£127,151,771			£127,151,771

Issue Department.—The figures in this part of the Return should be read in conjunction with what has been said about the *Bank Charter Act*, 1844 (*see* pp. 791–792). Notes have been issued to an aggregate value of £401,375,637. This aggregate value is made up of the Bank's original note issue, plus the amount of the currency notes transferred by the Treasury to the Bank. Of this aggregate, the amount of £29,557,842, is held in the banking department. In the old form of Return, one item only was given, viz. "Notes Issued," and the amount of the "active" issue, or the notes in circulation, had to be found by subtracting from the "Notes Issued" the amount

of notes held in the banking department. Now, the amount of notes in circulation is separately stated.

Against the liability of £401,375,637, the Bank holds as assets:—

(*a*) The debt due to it from the Government, £11,015,100. This is the original historic debt of the Government, created under the *Bank Charter Act*.

(*b*) "Other Government Securities," taken over from the Currency Note Redemption Account, amounting to £235,213,833.

(*c*) "Other Securities" (other than securities of the British Government, but doubtless of the finest quality) totalling £8,931,291. This amount comprises the £8,734,900 "Other Securities" that appeared in the old form of Return (which, with the Government debt of £11,015,000, made up the old amount of the fiduciary note issue, viz. £19,750,000) plus £186,391 of commercial bills of exchange. By S. 3 of the *Currency and Bank Notes Act*, 1928, the Bank is authorised to hold commercial bills as one of its assets against its fiduciary issue, so that in all probability this item of "Other Securities" will now fluctuate in amount.

(*d*) "Silver Coin." The Bank, though authorised by the *Bank Charter Act* to hold silver, had not done so for many years. This item of £4,839,776 comes from the Currency Note Redemption Account. Amongst other assets, the Bank took over from that Account the sum of £5,240,157 in silver coin. By S. 3 (2) of the *Currency and Bank Notes Act*, 1928, the Bank is authorised to hold silver coin, but not to a greater amount than £5,500,000.

(*e*) The items (*a*) (*b*) (*c*) and (*d*), aggregating £260,000,000, now constitute the backing to the Bank's fiduciary note issue. By S. 2 of the *Currency and Bank Notes Act*, 1928, the Bank is authorised to issue bank notes up to the amount representing the gold coin and bullion for the time being in its issue department, and in addition to issue bank notes to the amount of £260,000,000, in excess of the amount first mentioned. By the same section, the Treasury may, on being requested by the Bank, direct that the fiduciary note issue shall be reduced for such period and by such amount as the Treasury, after consultation with the Bank, may determine. By S. 8 of the same Act, if the Bank represent to the Treasury that it is expedient that the amount of the fiduciary issue should be increased to some specified amount above £260,000,000, the Treasury may authorise the Bank so to increase it, not exceeding the amount specified, for a period not exceeding six months, as the Treasury think proper; and such authority may be renewed or varied from time to time, but no authority is to be renewed so as to remain in force (whether with or without variation) after the expiration of a period of two years from the date on which it was originally given, unless Parliament otherwise determines; and any Treasury minute authorising an increase in the fiduciary issue shall be laid forthwith before both Houses of Parliament.

Banking Department (Debit Side).

Capital.—This item has remained unchanged since the year 1816.

The Rest.—This item represents the accumulated and undistributed profits of the Bank. It is the Bank's settled policy so to adjust the dividends paid to its stockholders that this item never falls below £3,000,000. Hence up to £3,000,000 it is a Reserve Fund, and above that amount it is the unappropriated balance of Profit and Loss.

Public Deposits.—The Bank acts as banker to the Government, and this item consists of the balances standing to the credit of the various Government Departments. The national revenue arising from receipts in respect of Customs and Excise, Income Tax, etc., is paid into the Bank as collected, and is drawn upon by the great Government spending departments to defray the cost of the Navy, Army, Air Force, Civil Service, etc.

Other Deposits:—

(*a*) *Bankers.*—These comprise the balances standing to the credit of all the *banking* customers of the Bank. First amongst these, both in significance and amount, are the accounts of the London clearing bankers. All these banker customers regard their balances with the Bank as a cash reserve upon which they can draw in case of need.

(*b*) *Other Accounts.*—This item represents the balances standing to the credit of the Bank's private customers, i.e. customers other than bankers. The Bank pays no interest on these balances. In the old form of Return, bankers' deposits and private customers' deposits were not discriminated, but were aggregated under the single heading, "Other Deposits."

Seven Day Bills.—These are also known as *Bank Post Bills.* They are bills issued free of charge against cash, drawn either by the Head Office upon one of the branches, or by one branch upon another branch, or upon Head Office. This form of remittance, at one time, in the old coaching days, extremely useful, is now, as the insignificant total shows, almost a thing of the past. There are no days of grace on Bank Post Bills.

Banking Department (Credit Side).

Government Securities.—These comprise every kind of Government security held by the Department, such as Treasury Bills, Consols, and the various War Loan securities, including also security for those temporary advances made by the Bank to the Government to enable the Government to meet expenditure in advance of income, known as *Ways and Means Advances*, and *Deficiency Advances.*

Other Securities.—These consist of the Bank's stock of discounted bills of exchange, stock exchange and other securities held as cover

against loans, and any other form of security held by the Bank so long as it is not an investment by the Bank itself in a security of the British Government. In the old form of Return this item was not analysed as between Discounts and Advances and Securities. It is understood that by "discounts and advances" is signified the accommodation granted to the money market at the request of the persons accommodated—bill brokers, discount houses, and others; and by "securities," the purchases of bills (other than Government securities, such as Treasury Bills, etc.) which the Bank effects on its own initiative.

Notes.—These notes are equivalent to gold, since the cover for them is the gold held by the Issue Department. By presenting these notes to the Issue Department for payment the following changes in the Returns of the Issue Department and Banking Department would be seen. In the Issue Department, the total of *Notes Issued* would be reduced by £29,557,842 to £371,817,795, and *Gold Coin and Bullion* by an equal amount to £111,817,915. In the Banking Department, the item *Notes* would disappear and the item *Gold* and *Silver Coin* would be increased to £30,792,449.

Gold and Silver Coin.—This is the Bank's till money.

It will be noted that while the operations of the Issue Department of the Bank are strictly regulated by law, yet in its Banking Department the Bank conducts an ordinary banking business in no way different from that of any other large bank, with the one exception that all its deposits are comparable with the Current Accounts of other banks.

The Bank Reserve.—The most important information disclosed by the Bank Return is the proportion which the Banking Department's holding of gold bears to its deposit liabilities. This proportion constitutes the Bank's *Cash Reserve.* It is not expressly stated but it is easily calculable. Thus, in the above return, the Bank's total *outside* liabilities in respect of Public Deposits, Other Deposits, and Seven Day Bills amount to £109,044,742. Against this liability the Bank holds notes, which are equivalent to gold, and gold and silver, amounting in all to £30,792,449. Consequently, the gold holding of the Banking Department, or the Reserve, in this Return is $28\frac{1}{4}$ % of its liabilities to its outside creditors. This amount of gold is practically the only free stock of gold in the country, for all the gold held by the Issue Department is earmarked for the punctual payment of the notes issued by that Department. The proportion in this Return is particularly low, and is due to exceptional and extremely large withdrawals in gold, of the balances held by France and Germany in our banks, and to the extra demands for currency on the part of the public, to meet the expenditure of the summer holiday season. The proportion has exceeded 50 %, and authoritative opinion inclines to the view that a proportion even higher than 50 % may have to be maintained. Before the great expansion of the fiduciary issue, the Bank's note issue was

backed by nearly 100 % of gold, but in this Return the proportion of gold held by the Bank against the total note issue is roughly about 35 %

THE SIGNIFICANCE OF THE BANK OF ENGLAND'S RESERVE.

The Bank of England is, so to speak, the hinge upon which hangs and turns the whole banking system of this country, and as such its functions and methods of business differ in some respects from those of all other British banks. Two of these differences have already been noted, viz. that the whole of its deposits are repayable in legal tender on demand, and that generally it pays no interest upon its deposits. With these exceptions, banking in this country consists of borrowing money at one rate of interest, and lending and investing the borrowed money at a higher rate of interest, the difference between the interest paid and the interest earned on the assets being the chief source of banking profits.

Apart from the Bank of England, a bank borrows money from its customers in two ways, viz. (*a*) on Current Account, (*b*) on Deposit Account. On current account balances no interest is paid (though some banks pay interest on their customers' current account balances when these are of large amount); on deposit account balances interest is credited half-yearly at 2 % below current Bank Rate. *Bank Rate* is the official minimum rate at which the Bank of England will discount approved bills of exchange for persons other than its own customers. The whole of a bank's current account balances are repayable in legal tender on demand; its deposit account balances are also repayable in legal tender, but before customers can withdraw their deposit balances they must have given such period of notice (seven days or more) as may have been agreed with the bank when the deposits were made. This notice is, in practice, frequently waived by banks.

Employment of a Bank's Assets.—On July 31, 1927, the liability of the National Provincial Bank, Limited, in respect of "Current, Deposit, and other Accounts" aggregated over 258 million pounds. The unspecified amount that this one bank is liable to pay in legal tender on demand is obviously enormous. If we take the liability of all the British banks in respect of this item, "Current, Deposit, and other Accounts," it must, in the aggregate, considerably exceed two thousand million pounds.

Clearly, it is of the first importance that every bank should so employ its assets in the earning of interest as always to be able to discharge in legal tender on demand every claim that may be made upon it. The precise proportion of its assets that a bank must keep in legal tender, the proportion that it can lend, the proportion that it can lock up in investments, and the modes of its lending and investing, are of the essence of successful banking. The actual employment of the assets of the National Provincial Bank, Limited, designed, as must always be the object of banking, to secure (*a*) punctual payment

in legal tender of all debts due and demanded in that form, (*b*) permanent stability of the bank, (*c*) the best interest return on the assets, is illustrated in the following Statement of Accounts of the bank.

National Provincial Bank, Limited.

STATEMENT OF ACCOUNTS (WEEKLY AVERAGES)

Capital :—Authorised, £60,000,000. Subscribed, £43,617,080.
Paid, £9,479,416. Uncalled, £5,839,611.
(*a*) Reserve Liability, £28,298,053. Reserve Fund, £9,479,416.

LIABILITIES.	£ in millions.	ASSETS.	£ in millions.
Current, Deposit, and other Accounts	258·05	(*b*) Coin, Bank of England and Currency Notes and Balances with the Bank of England	28·43
(*j*) Liabilities for Acceptances, Indorsements, etc., as per contra ..	10·75	(*c*) Balances with and cheques in course of collection on other Banks	7·76
(*k*) Surplus	18·94	(*d*) Money at Call and Short Notice	18·22
		(*e*) Investments	35·50
		(*f*) Investments in Affiliated Banks	2·75
		(*g*) Bills Discounted	33·92
		(*h*) Advances to Customers	145·10
		(*i*) Bank Premises	5·31
		(*j*) Liabilities of Customers for Acceptances, Indorsements, etc., as per contra	10·75
	£287·74		£287·74

(*a*) Many banks have availed themselves of the provision re-enacted in S. 49 of the *Companies Act*, 1929, to create *reserve liability*. Here we see that £28,298,053 of this bank's subscribed capital of £43,617,080 has been constituted a reserve liability of the shareholders of the bank that can be called up only in the event of winding up. Reserve liability of this magnitude contributes to the confidence of the customers in the stability of the bank.

(*b*) It is impossible to say what proportion of this amount is held by the bank itself and what by the Bank of England. It is safe to assume that the proportion in the keeping of the Bank of England is very large; and the point to remember about this proportion is that the whole of it is treated by the bank as part of its cash that can be withdrawn from the Bank of England at any time. This item is the most liquid asset of the bank, and its first line of defence.

(*c*) This item may be considered as actual cash. The balances

with other banks are all payable on demand, and the cheques in course of collection will actually be collected through the Clearing House in the course of a few hours (except unpaids). But it must be remembered that other banks have similar items against the National Provincial. Hence it is the *balance* between the National Provincial's claims upon other banks, and those other banks' claims upon the National Provincial that really matters. If, at any particular moment of time, all these cross claims were settled, the result would be an increase in the National Provincial's cash at the Bank of England if the *balance* were in favour of the National Provincial, and a diminution in its cash if the *balance* were against the National Provincial.

(*d*) This item represents money lent in the London Short Loan Money Market to bill brokers, stockbrokers, and others at rates varying with the monetary resources of the market, and the demand for loanable capital. Thus for the second quarter of 1927, with Bank rate at $4\frac{1}{2}$ %, the rates for day to day loans and weekly money varied from 3 to $3\frac{1}{2}$ %. Next to the bank's own cash and its balance with the Bank of England this is the most liquid asset of the bank, for the money lent (against security) is repayable at call, or within seven days (weekly money) and is easily called in.

(*e*) These are long term investments, mainly in Government securities, guaranteed by the British Government, earning variable rates of interest or dividend. They cannot be turned into cash except by degrees, and in favourable states of the investment market, if losses on realisation are to be avoided.

(*f*) These investments are comparable with the investments of large trading and manufacturing concerns in subsidiaries and allied institutions. They are permanent investments, having been made to extend the bank's business.

(*g*) The discounting of Bills of Exchange is one of the soundest modes of a bank's investing, since payment of the bills is guaranteed by the parties to them, and they represent real exchanges of values. Moreover, a proportion of them matures daily for payment, fresh bills taking their place. First in importance is the bank's holding of Treasury Bills (unfunded Government borrowings) issued payable within three or six months, and earning interest varying with money market resources. During the second quarter of 1927, the rough discount average was about $\frac{3}{16}$ths % below the then Bank Rate of $4\frac{1}{2}$ %. Then come bank and fine trade bills. The rates of discount charged on these bills vary with the security offered by, and the tenor of, the bills. Drafts payable within sixty days to which bankers have become parties (bankers' bills) were discounted during the second quarter of 1927 at about the same rates as Treasury Bills; similar drafts at six months at a fraction higher discount. Trade bills (sound commercial paper) were discounted at Bank Rate, or at $\frac{1}{2}$ to 1 % above Bank Rate, the rate of discount being lowest for three months' bills and

Jones, as occupier, pays on £35 @ 5s. 6d. = £9 11s. 9d. Schedule A tax for 1938–39 on January 1, 1939, and deducts this from the £10 rent due from him on March 25, 1939. It will be noted that in this case Jones cannot deduct tax at 5s. 6d. from his total rent of £40 per annum, but is restricted to the amount he actually paid.

Schedule B.—This Schedule relates to the profits arising from the *occupation* of land in Great Britain and Northern Ireland. Land occupied by a dwelling-house, warehouse, or other building (except a farm building) is exempt.

The basis of assessment is the assessable value, which, in the case of land not occupied for husbandry, is one-third of the G.A.V. as fixed for Schedule A. This covers sports grounds, woodlands, golf links, gardens, etc. (but not market-gardens, or nurseries, which are assessed under Schedule D, Case I). The assessable value, in the case of land occupied solely or mainly for the purpose of husbandry, e.g. farms, is the full G.A.V. as fixed for Schedule A. The farmer, however, may have his Schedule B assessment reduced if he can produce accounts at the end of the year and prove that his actual profits were less than the assessment. Should he sustain an actual loss on the year's working, his Schedule B assessment is discharged and he may reclaim tax on the amount of the loss against tax paid on any other source of income. It will be seen later that this is a much more favourable treatment than that applicable to other businesses under similar circumstances. Other trades and professions are assessed under Schedule D on the profits of the preceding year, and the farmer has the option of choosing this method of assessment in any year instead of a Schedule B assessment on the G.A.V. The valuable feature of this option is that it can be exercised in any year by giving notice on or before June 5th, at the commencement of year of assessment. Such election only affects the one year. The following year he will be assessed under Schedule B unless he again elects to have a Schedule D assessment. Woodlands, managed on a commercial basis, may be assessed under Schedule D instead of under Schedule B at the option of the occupier. But, unlike the farmer, such election has effect, not only as regards the year of assessment, but also to all future years of assessment, so long as the woodlands are occupied by the person making the election.

Illustration (4).—Abel Chatenay (see Illustration 1) would be assessed under Schedule B for 1938–39 on £400, the amount of the gross Schedule A assessment.

If, on making up accounts for the year to March 25, 1939 (or the usual date to which he makes up his accounts), he found that his profit (after taking into account produce consumed by himself and his family) amounted to only £300, he could, by giving notice to the Inspector of Taxes before April 6, 1940, require that his 1938–39 Schedule B assessment should be reduced to £300. He could also, by notice in writing delivered personally or sent by registered post to the Inspector before June 6, 1938, elect to be assessed under Schedule D instead of under Schedule B for 1938–39, this assessment would be based on the income of the preceding year, instead of the assessable value £400.

Schedule C.—This Schedule relates to the Interest payable in Great Britain and Northern Ireland out of "Public Funds" whether Imperial, Colonial, or Foreign, and includes the interest paid on Consols, War Loans, and other Government Stocks, Public Annuities, etc. The tax on this type of income is deducted at the source at the standard rate in force at the date of payment and handed over to the Revenue in one lump sum by the bank or other agent entrusted with the payment. This is an example of the application of the principle of deduction of tax at the source. Exceptions are made in the case of (i) interest on $3\frac{1}{2}$ % War Loan, and (ii) interest on any other payments out of the public revenue where the half-yearly payment does not exceed fifty shillings, provided in both cases that the securities are not bearer securities. Such income does not escape tax, but has to be returned by the recipient for assessment under Case III, Schedule D.

Students are very apt to confuse Schedule C with Case III of Schedule D (which deals with interest which reaches the taxpayer without tax having been deducted) and should carefully study the points of difference.

Schedule D—This Schedule deals with income arising or accruing:—

(*a*) to any person residing in Great Britain and Northern Ireland (G.B. & N.I.) from any kind of property whatever, whether situate in G.B. & N.I. or elsewhere; and

(*b*) to any person residing in G.B. & N.I. from any trade, profession, or vocation, whether the same be respectively carried on in G.B. & N.I. or elsewhere; and

(*c*) to any person, whether a British subject or not, although not resident in G.B. & N.I., from any property whatever in G.B. & N.I., or from any trade, profession, or vocation exercised within G.B. & N.I.; and

(*d*) from interest of money, annuities, and other annual profits or gains not charged under Schedule A, B, C or E, and not specially exempted from tax.

This Schedule is divided into six "Cases," each case dealing with income from a definite source and each case having its own rules relating to the assessment of such income as falls within the limits of that case.

Case I deals with the profits of Trades, Manufactures, and Businesses not within any other Schedule.

Case II deals with the profits of Professions and Vocations not within any other Schedule.

The assessment, in both cases, is based on the amount of the income from these sources arising in the preceding year, except in the first three and the last two years in which the income arises, when special rules apply (*see* pp. 849 and 857).

the second year will also be based on the income of the year of assessment unless the income first arose on April 6th in the preceding year. The taxpayer may, however, claim to be assessed in the first and second *complete* years on the actual income of those years. In the year in which the income ceases, the assessment will be on the income from April 6th to the date of the cessation, and an additional assessment will be made in respect of the preceding year if the income of that year was in excess of the original assessment.

There are three exceptions to the change in the basis of assessment, viz.:—

1. Leave pay.
2. Remuneration from any office or employment held or exercised occasionally or intermittently in the U.K. by a person who is not continuously resident there.
3. Manual weekly wage-earners.

   These are still assessable on the actual remuneration of the year of assessment.

Manual Weekly Wage-earners are assessed half-yearly on the actual wages received in the previous half-year. The first half-year ends on October 5th, and the second half-year on April 5th. This provision is merely to facilitate collection of the tax, and if tax has been paid in the two half-years in excess of the tax due on the whole year's wages, the excess will be repaid. The expression "weekly wage-earners" means persons who receive wages which are calculated by reference to the hour, day, week, or any period less than a month, at whatever intervals the wages may be paid, or who receive wages, however calculated, which are paid daily, weekly, or at less intervals than a month. "Manual" Labour includes all occupations which depend mainly on the exercise of physical exertion, even though a considerable amount of dexterity and training may be involved, but does not include employment as clerks, typists, draftsmen, or in any other similar capacity.

Every employer is required to prepare and deliver to the Inspector a return of the names and places of residence of any persons employed by him, and of the payments made to them in respect of their employment for the year of assessment. Where such total payments do not exceed £125 per annum, and the person is not otherwise employed, such person may be omitted from the return. In the case of Manual Weekly Wage-earners the return is made half-yearly.

Schedule D, Cases I and II.—This part of Schedule D must be dealt with at some length. It has already been stated that these two cases deal with the income derived from trades and businesses, professions and vocations. "Income" is not synonymous with the term "net profit," and although the accounts of the trade, etc., are used as a basis for computing the liability, the net profit shown by such

accounts must be adjusted in order to arrive at the figure representing profit from the income tax point of view. For example, it may be deemed prudent in the accounts of the business to write off depreciation of buildings, furniture, and other capital assets. Such decrease in value, however, is looked upon as a capital loss for income tax purposes, and the amount charged in the accounts must be "written back," i.e. added to the profit shown by the accounts. In adjusting the profits shown by the accounts of the business, no sum is to be deducted in respect of any expenses not wholly and exclusively incurred for the purposes of the trade, profession, or vocation.

The deductions allowable include :—

Sums expended for repairs of premises occupied for the purposes of the trade, etc., or for the renewal or repair of implements, utensils, or articles employed.

Debts proved to be bad, and doubtful debts to the extent that they are respectively estimated to be bad.

The rent of premises used solely for the purposes of the business, and not as a place of residence.

The annual value of any premises within G.B. & N.I. used solely for the purposes of the business and not as a place of residence. Where, however, the premises are held at a rent less than the Annual Value, only the excess of the Annual Value over such rent is allowed as a deduction in addition to the rent. (The Annual Value to be taken for this purpose is the amount of the Schedule A assessment as reduced by the statutory allowance for repairs, except in the case of Mills, Factories, or other similar premises where the gross annual value is allowed.)

A proportion not exceeding two-thirds of the Annual Value (as reduced by the statutory allowance for repairs) of any dwelling-house within G.B. & N.I. partly used for the purposes of the business, unless in a particular case it is proved that some greater sum ought to be allowed. Where, however, the dwelling-house is held at a rent less than the Annual Value, the amount to be allowed on account of Annual Value is to be reduced by the corresponding amount of rent already allowed as a deduction.

One-sixth of the Annual Value of any Mills, Factories, or similar premises situate outside G.B. & N.I. and occupied by the owner for the purposes of the trade. Annual Value for this purpose is to be computed according to the principles governing the estimation of the Annual Value, for the purposes of Schedule A, of similar premises in G.B. or N.I.—that is, in general, by reference to the rack-rent at which the premises are worth to be let by the year.

The amount charged to British Tax on account of lands, tenements, hereditaments, or other premises situate in the Irish Free State to the extent that they are used for the purpose of the business.

So much of any amount expended in replacing obsolete plant or machinery as is equal to the cost of the plant or machinery replaced,

after deducting from such cost (*a*) the total amount of any allowances made at any time on account of the wear and tear of such plant or machinery and (*b*) any sum realised by its sale.

No deductions are allowable for :—Any sums paid as salaries to proprietors, or for any interest on capital, or for drawings by proprietors.

Any expenses of maintenance of the persons assessable, their families, or establishments; or for any sum expended for any other domestic or private purpose.

Any annual interest, annuity, ground rent, or other annual payment, payable out of the profits or gains, or for any royalty or other sum paid in respect of the user of a patent. (The tax on such interest, patent, royalty, or other annual payment should be deducted from the person to whom the payment is made.)

Any sum paid as British Income Tax on profits or gains, or on the Annual Value of trade premises, and any sum paid as Dominion Income Tax (except in cases where no deduction in respect of British Tax is allowed in the Dominion). Foreign Income Tax paid in respect of the profits in the place where they arise may, however, be deducted.

Any sums invested or employed as capital in the trade, etc., or in respect of capital withdrawn therefrom.

Any sums expended in improvement of premises, or written off for depreciation of land, buildings, or leases, or other assets.

Wear and tear of machinery and plant; but an allowance may be claimed in respect of this item (*see* p. 850).

Any loss not connected with or arising out of the trade, etc.

Any loss recoverable under an insurance or contract of indemnity.

Basis of Assessment, Cases I and II, Schedule D.—Having adjusted the profits shown by the business accounts, the assessment on such income can be computed. The assessment is to be made on the basis of the full amount of the profits or gains of the year preceding the year of assessment. But if the trade, etc., has been commenced within the preceding year, the profits or gains for one year from the commencement are to be taken (subject to the right to have both this and the following assessment based on the actual profits of the respective years of assessment by giving the requisite notice to the Inspector of Taxes). If commenced within the year of assessment, the rules of Case VI apply, and the practice is to take the actual profit from the date of commencement to April 5th following.

Wear and Tear.—In adjusting the profits as shown by the business accounts, any amounts written off for depreciation of assets must be written back, i.e. added to the profit. However, where plant or machinery (including trade fixtures, motor-cars, doctors' and dentists' instruments, etc.) belongs to the taxpayer, or is so let

to him that he is bound to maintain it and deliver it over in good condition, an allowance may be claimed for diminished value of the machinery or plant by reason of wear and tear during the year of assessment. In the case of ships, the allowance is calculated on prime cost, but in all other cases the allowance is granted by way of a percentage on the written-down value. The percentage varies in different businesses and in respect of different types of machinery; it may be as low as 3 % (Tramway and Electric Light Cables) or as high as 22½ % (Tractor Cultivators used in Farming). Different rates are agreed from time to time on various classes of plant or machinery by agreement between the Inland Revenue authorities and the users of such plant or machinery. In practice, the allowance is calculated on the written-down value at the beginning of the fiscal year and is deducted from the assessment. If the assessment for any year is less than the Wear and Tear due, the balance of the Wear and Tear allowance may be carried forward year by year until the full allowance has been made. The allowance is only granted if claimed on the return form. If no such claim is made in any year, that year's allowance is lost, but the next year's allowance is calculated as if wear and tear had been allowed in the previous year. The Wear and Tear allowance is now granted in assessing the profits of professions and vocations, employments and offices, whether assessed under Schedule D or not, and to profits arising from the occupation of lands (including woodlands) where such profits or gains are ascertained otherwise than by reference to assessable value. Where the Wear and Tear is granted, ordinary repairs to plant and machinery are allowed as business expenses, but the cost of acquiring assets and of renewing them must be charged to capital. However, where plant or machinery has become obsolete, an allowance may be claimed, as a business expense of the year in which it is replaced, equivalent to the written-down value of the obsolete machinery less any sum realised by its sale, but not exceeding the cost of replacing it. From 1932–33 to 1937–38 inclusive all Wear and Tear Allowances have been increased by a sum equal to 10 per cent. of the allowances and for 1938–39 this increase is 20 per cent. For the purpose of calculating the "carry forward" this increase is ignored, but it must be brought into account when considering obsolescence claims. The method of treatment will be best understood by considering the example which follows.

Renewals.—If the Wear and Tear allowance is not claimed, the cost of renewing plant and machinery may be charged against profits less any scrap or residual value of the old plant or machinery. Improvements and additions, however, must be charged to capital.

General Illustration.—A Limited Company commenced business on January 1, 1935. The Profit and Loss Accounts for the three years ended December 31, 1935, 1936, and 1937, are set out on p. 851.

PROFIT AND LOSS ACCOUNT.

	1935.	1936.	1937.		1935.	1936.	1937.
	£	£	£		£	£	£
To Salaries	1 000	1,500	1,900	By Gross Profit, as per Trading Account ..	4,224	4,809	10,684
,, Rates, Lighting and Heating	400	420	450	,, Bank Interest	8	16	22
,, Advertising	500	400	300	,, Investment Interest	25	100	200
,, Discounts	20	50	70	,, Net Losses	1,200	1,000	—
,, Income Tax	100	120	110				
,, Debenture Interest	400	400	400				
,, Bank Interest	10	18	6				
,, Repairs to Plant	24	24	52				
,, Depreciation of Plant	1,000	800	752				
,, Loss on Sale of Plant	—	—	600				
,, Directors' Fees	1,000	1,000	1,000				
,, Preliminary Expenses	33	33	33				
,, General Expenses	950	1,160	1,540				
,, Net Profit	—	—	3,693				
	£5,457	£5,925	£10,906		£5,457	£5,925	£10,906

Solution.

PROFIT AND LOSS ADJUSTMENT ACCOUNT.

	1935.	1936.	1937.		1935.	1936.	1937.
	£	£	£		£	£	£
To Net Losses, as per Accounts	1,200	1,000	—	By Net Profit, as per Accounts	—	—	3,693
,, Bank Interest (*b*)	8	16	22	,, Advertising	200	50	—
,, Investment Interest (*b*)	25	100	200	,, Income Tax	100	120	110
,, G.A.V. of Factory (*c*)	350	350	350	,, Debenture Interest (*a*)	400	400	400
,, One-sixth Annual Value of Factory abroad	9	9	9	,, Depreciation of Plant	1,000	800	752
,, Obsolescence Allowance (*d*)	—	—	662	,, Loss on Sale of Plant	—	—	600
,, Adjusted Profits	151	—	4,360	,, Preliminary Expenses	33	33	33
				,, Subscriptions and Donations	10	15	15
				,, Adjusted Loss	—	57	—
	£1,743	£1,475	£5,603		£1,743	£1,475	£5,603

The Inspector required an analysis of the item General Expenses, and refused to allow the following sums for charitable subscriptions and donations, which had been included in the amount: 1935, £10; 1936, £15; 1937, £15. He also disallowed the following Advertising charges as being of a capital nature, creating goodwill, etc.: 1935, £200; 1936, £50. The Company owns the factory premises, assessed under Schedule A at £350 gross, and also a small factory in France worth £54 per annum. The machinery cost £5,000 in March 1935, and one machine costing £1,000 was scrapped as obsolete in 1937, and realised £40. It was replaced in the same year by a machine costing £1,200. The Wear and Tear allowance was agreed at 10 %. Show the Case I, Schedule D, assessments.

Notes.—(*a*) This item is written back, since tax is deducted from this interest by the Company.

(*b*) These items are extracted from the profits, as they are assessable under Case III, Schedule D, unless tax has already been deducted at the source.

(*c*) Since the Company pays under Schedule A on the N.A.V. only, an additional allowance is made here equivalent to the difference between the Gross and the Net Annual Value. In effect, this is an allowance for depreciation of buildings.

(*d*) The Wear and Tear allowance and the Obsolescence allowance are computed as follows:—

MEMO. PLANT ACCOUNT FOR WEAR AND TEAR COMPUTATION.

		Additional Allowance.	Total Wear and Tear.	Machine Scrapped		
Cost, March 1935	£5,000			1,000		
1935–36	500	+ 50	= 550	100	+ 10	= 110
	4,500			900		
1936–37	450	+ 45	= 495	90	+ 9	= 99
	4,050			810		
1937–38	405	+ 41	= 446	81	+ 8	= 89
	3,645			£729		£298
Less Written down value of machine scrapped ..	729					
	2,916					
Cost of new machine ..	1,200					
	4,116					
1938–39	412	+ 82	= 494			
Balance forward ..	£3,704					

Obsolescence Claim.

Cost	£1,000
Less Wear and Tear allowed	298
	702
Less Cash received ..	40
Allowance ..	£662

Since Wear and Tear is calculated on the written-down value at the commencement of the fiscal year, it will be noted that a full year's allowance is granted for 1937–38 on the machine scrapped during 1937;

on the other hand, the machine purchased in 1937 does not come in for Wear and Tear until 1938–39.

From an income tax point of view, the results of the business were as follows :—

Year ended 31st December, 1935, Profit..	..	£151
Year ended 31st December, 1936, Loss ..	..	£57
Year ended 31st December, 1937, Profit..	..	£4,360

The assessments will be as follows, under Case I, Schedule D.

1934–35.—The business was in existence from January 1, 1935, to April 5, 1935, during this year, and the assessment will be based on the actual profit earned during this period. This is found by apportioning in months and fractions of months the profits for the first year, which includes this period :—

i.e. $3\frac{1}{6}$ months at £151 p.a. = £40.

As there is no Wear and Tear allowance for this year, tax would be paid on £40 at 4s. 6d. = £9.

1935–36.—The business was set up or commenced within the preceding fiscal year, so that the assessment is to be based on the profits of one year from the first setting up of the business, i.e. in this case the profits of the year ended December 31, 1935.

The assessment will thus be	£151
Against which can be set-off the Wear and Tear Allowance of..	550
Leaving a balance of Wear and Tear Allowance to be carried forward of	£399

Under *Section* 15 *of the Finance Act*, 1930 :—

"The person charged for the second year of assessment shall be entitled, on giving notice in writing to the (inspector) within two years after the end of the second year, to require that tax shall be charged for both the second year of assessment and the third year of assessment (but not for one or other only of those years) on the amount of the profits or gains of each such year respectively."

Thus, on giving notice before April 6, 1938, the Company could claim to have the 1935–36 assessment reduced to

$\left(8\frac{5}{6} \times \frac{151}{12}\right) - \left(3\frac{1}{6} \times \frac{57}{12}\right)$ .. .. .. =	£96
Wear and Tear, 1935–36	550
Revised Wear and Tear balance carried forward ..	£454

1936–37.—The normal basis to be taken is the normal accounting period ended during the preceding tax year (unless no account for a period of one year was made up to a date within the preceding tax year, in which case the Commissioners of Inland Revenue decide which

period of twelve months should be taken. Reference should be made to S. 14, Finance Act, 1930).

The assessment would thus be based on the profits of the year ended 31st December, 1935		£151
Less Wear and Tear Allowance, 1936–37 ..	£495	
Add amount brought forward	399	
		894
Wear and Tear, carried forward		£743

But if the company has made a claim under S. 15, *Finance Act*, 1930, as indicated on the previous page, the assessment for 1936–37, being the third year of assessment, must then be upon the profits of that fiscal year, i.e.

$\left(3\frac{1}{6} \times \frac{4{,}360}{12}\right) - \left(8\frac{5}{6} \times \frac{57}{12}\right)$		= £1,109
Less Wear and Tear Allowance, 1936–37 ..	£495	
Add amount brought forward ..	454	
		949
Assessment, 1936–37		£160

If, therefore, the company had claimed such an adjustment, it would have been prejudiced, and would utilize the power given in the proviso to S. 15, Finance Act, 1930, to revoke the notice. The final assessments for 1935–36 and 1936–37 would thus be *nil*, and a balance of Wear and Tear amounting to £743 would be carried forward.

1937–38.—The normal preceding year basis is adopted from this year onwards (unless the usual accounting date and period was departed from, in which case the Commissioners of Inland Revenue decide which period of twelve months should be taken).

The assessment based on the results of the preceding year, i.e. year to December 31, 1936, will be *nil*, since the adjusted result of the year is a loss of £57. This loss can be carried forward for six years from the year in which it was incurred (1937–38) and set-off against the next assessment made on the business profits during those six years.

Since there is no assessment this year, the loss is carried forward to 1938–39; also the Wear and Tear Allowance, provided it is claimed on the return form.

If a claim is made under *Section* 34, *I.T.A.*, 1918 (*see* below), the right to carry the loss forward is lost.

1938–39.—The profit of the preceding year to December 31, 1937, was £4,360
and that figure forms the assessment this year
Less the Wear and Tear Allowance.

Brought Forward from 1936–37	£743	
Allowance brought forward from 1937-38..	446	
Allowance for 1938–39	494	
		1,683
		2,677
Less loss brought forward		57
Assessment, 1938-39		£2,620

It should be noted that the Wear and Tear Allowance is required to be deducted before the loss brought forward can be deducted.

Losses in Business.—(1) If, after adjusting the business accounts, a loss is shown to have been made during the year, a claim may be made by the person incurring the loss to have a repayment made for the year in which the loss was incurred. This claim (under *Sec.* 34, *Income Tax Act*, 1918) must be made within one year after the end of the year of assessment in which the loss occurred. The repayment due is calculated by setting-off the amount of the adjusted loss against the total income for the year. Included in such total income will be, of course, the original assessment on the business, which, based on the profit of the preceding year, is not affected by the actual result.

Illustration (5).—The total income of the X.L. Co., Ltd., for the year 1937–38 was :—

Case I, Schedule D assessment	£1,000
Case III, Schedule D assessment	50
N.A.V. of Premises owned by Company	200
	£1,250

on which tax was paid at the full Standard Rate. The result of the year to March 31, 1938, was a loss of £1,500. This is greater than the total income for the year, and the repayment is thus £1,250 @ 5s. 0d. = £312 10s. 0d.

The balance of the loss may be carried forward for six years (*see* below).

(2) The assessment for the year following the year in which a loss was incurred will be *nil.*

But if the loss was incurred in a *trade* carried on by an individual either as a sole-trader or in partnership, and that individual carries on another *trade*, he may, under Rule 13, Cases I and II, Schedule D, set-off the " preceding year " loss in one trade (or his share of it as a partner) against the " preceding year " profit in the other trade (or his share of such profit).

Illustration (6).—Smith carried on a trade as tobacconist. The results were as follows, after adjustments for income tax purposes :—

Year ended December 31, 1935, Profit	.. .. ..	£350
1936, Profit	.. .. ..	£460
1937, Profit	.. .. ..	£450

He also had a one-third interest with his brother in a motor coach concern, the adjusted results of which were as follows :—

Year to December 31, 1935, Profit	.. ..	£520
1936, Loss	.. ..	£150
1937, Profit	.. ..	£210

The normal assessments will be :—

	Tobacconist.	Motor Coach.
1936–37	£350	£520
1937–38	460	—
1938–39	450	210*

Assuming no claim is made under Section 34 for 1936–37, Smith may claim (under Rule 13) in 1937–38 to set-off against the assessment on his tobacconist business his share of the loss during the preceding year on the motor coach business.

Thus :—

1937–38 assessment as tobacconist	£460
Less One-third loss on other trade	50
Revised 1937–38 assessment	£410

The loss carried forward on the motor coach business would be diminished by the £50 claimed under Rule 13.

(3) Where a person has sustained a loss in any trade, profession, or vocation in respect of which no relief has been given under *Section* 34, *Income Tax Act*, 1918, or *Rule* 13, *Cases I & II*, *Schedule D*, or under any other provision of the Income Tax Acts, he may claim that any portion of the loss for which relief has not been so given may be carried forward and, as far as may be, deducted from or set-off against the Schedule D assessment on him in respect of that trade, etc., for the six following years of assessment. The relief is to be given as far as possible from the first subsequent assessment for any year within the said six following years, and so far as it cannot be so given, then from the next, and so on (*Sec.* 33, *Finance Act*, 1926). This provision applies to a loss sustained by a person :—

(*a*) who is in occupation of lands and who, by reason of his election under Rule 5 of Schedule B, is chargeable under Schedule D ; or

(*b*) who is in the occupation of woodlands and has elected to be charged under Schedule D ; or

(*c*) in any transaction of such a nature that if a profit had resulted, he would have been liable to assessment under Case VI of Schedule D, but such loss may only be set-off against future Case VI assessments (*Sec.* 27, *F.A.*, 1927) ; or

(*d*) who has since transferred his business to a company in consideration solely or mainly of the allotment of shares in the company to him. Such loss may be set-off against

* Subject to loss brought forward.

future income derived by him from the company (*Sec.* 29, *F.A.*, 1927).

Illustration (7).—Jones, who has no income from any other source, made a loss on his boot business for the year ended December 31, 1934, of £400. The results of subsequent years were :—

Year ended December 31, 1935, Profit	.. .. ..	£50
1936, Profit	.. .. ..	100
1937, Profit	.. .. ..	900

His assessments will be :—

1935–36	Nil	Loss carried forward	£400
1936–37, 50 − 50 =	Nil	Loss carried forward	350
1937–38, 100 − 100 =	Nil	Loss carried forward	250
1938–39, 900 − 250 =	650	Loss carried forward	Nil

Although, owing to his personal allowances, no tax would have been paid in 1936–37 and 1937–38 in any event, yet he must set off the 1934 loss against the *next* assessment and cannot carry forward the whole loss to 1938–39.

Discontinuance of Business.—If a person ceases to carry on a business, either owing to the business having been completely closed down or merely transferred or sold, his assessment for the year in which the business was discontinued by him will be made upon his actual profits from April 5th prior. Also, if it appears that his actual profit for the preceding fiscal year was greater than the assessment, an additional assessment will be made.

It should be noted that there is no provision under which the taxpayer can have his assessment reduced for the year prior to the year of discontinuance, but it will be remembered that in his second and third year of business he has the right to have his assessment adjusted to actual, and the Revenue cannot increase those assessments if the actual profits are greater.

Illustration (8).—Uprichard commenced business on January 1, 1935, and ceased business on December 31, 1938. His adjusted profits were :—

Year to December 31, 1935	.. ..	£300
1936	.. ..	6,000
1937	.. ..	7,200
1938	.. ..	1,200

Normal Assessments.		Amended to.
1934–35, $\frac{19}{6} \times \frac{300}{12}$ .. .. .. =	£79	
1935–36, Profit of first 12 months =	300	(No adjustment claimed, since actual profits are greater.)
1936–37, Profit of preceding year =	300	
1937–38, Profit of preceding year =	6,000	(No adjustment, since actual profit is lower, i.e. $\left(8\tfrac{5}{6} \times \frac{7,200}{12} + 3\tfrac{1}{6} \times \frac{1,200}{12}\right) = £5,616.$)
1938–39, Profit of preceding year =	7,200	Profits to actual date of discontinuance $= \left(8\tfrac{5}{6} \times \frac{1,200}{12}\right) = £884.$

Illustration (9).—George Dickson purchased a grocery stores on October 5, 1932. The adjusted results were :—

Year to October 5, 1933, Profit	£900
Year to October 5, 1934, Profit	600
Year to October 5, 1935, Loss	72
Year to October 5, 1936, Profit	24
Year to October 5, 1937, Profit	300
Period to January 31, 1938, Profit	100

He sold the business on January 31, 1938.

Normal Assessments.		Amended to.
1932–33, ½ of 900	= 450	
1933–34, First 12 months	= 900	Reduced to actual ½ of £900 + ½ of £600 = £750.
1934–35, Preceding year	= 900	Reduced to actual ½ of £600 − ½ of £72 = £264.
1935–36, Preceding year	= 600	
1936–37, Preceding year	Nil	Increased to actual (½ of 24 + ½ of 360) = 192
		Less Loss brought forward .. 72
		£120
1937–38 Preceding year 24		
Loss brought forward 72		
—	Nil	Actual (½ of 360) + 100 = £280.

Changes of Ownership.—If a business changes hands the vendor is treated as having discontinued the business on the date of sale and the purchaser as having set up a new business at that date.

The only exception is in the case of a change of partnership where at least one individual, who was engaged in the trade, profession or vocation *until* the change, *continues* to be engaged in it. In such cases the assessment on the business continues on the basis of the preceding year, as if no change had taken place. But if all the persons who were engaged in the trade, etc., both immediately before and immediately after the change make application, by notice signed by all of them (or, in the case of a deceased person, by his legal representative) sent to the Inspector of Taxes within 12 months after the change took place, the assessments both before and after the change will be adjusted as if the trade, etc., had been discontinued at the date of the change and a new one had been set up (*Sec.* 32, *Finance Act*, 1926, as amended by *Sec.* 16, *Finance Act*, 1930).

Cases III, IV, and V, Schedule D.—Although the normal basis here is the "preceding year," adjustments are made, as in the case of businesses, when the income first arises and when it ceases.

At the beginning :—

(1) As respects the year of assessment in which the income first arises, tax is computed on the full amount arising within the year.

(2) Where the income first arose on some day in the preceding year, other than April 6th, the tax for the second year is computed on the income of that second year.

(3) Where the income first arose on some day in the year next before the preceding year other than April 6th, or on April 6th

in the year preceding the year of assessment, the taxpayer has the right, on giving notice in writing to the Inspector of Taxes within 12 months after the end of the year of assessment, to have his assessment reduced to the amount of his income for that year.

At the end :—

The adjustments are the same as in the case of a trade, etc., which has been discontinued, that is to say the assessment for the year in which the person ceases to possess a source of income is based on the actual income of that year. If the income of the preceding year exceeds the assessment for that year, an additional assessment is made on the excess, but the taxpayer has no claim should the income of this year fall short of the assessment.

Such adjustments are made not only when a person acquires a new source or ceases to possess a particular source of income chargeable under Cases III, IV, or V, but also when a person acquires an *addition* to any source or ceases to possess any *part* of any source.

Illustration (10).—A British subject resident in England derived income from foreign shares as follows :—

	German Shares.	French Shares.
	£	£
Year to April 5, 1933	10	200
1934	87	390
1935	50	360
1936	Nil	410
1937	30	420
1938	12	380

The income on the German shares first arose on January 1, 1933, and on the French shares on April 6, 1932.

The German shares were sold on December 31, 1937

Assessments under Case V, Schedule D :—

	On German Shares. Normal Assessment.	Amended to.	On French Shares.
	£	£	£
1932–33 .. .. (actual)	10	—	200 (actual)
1933–34 .. .. (actual)	87	—	200 (preceding year)
1934–35 (preceding year)	87	50 (actual)	390
1935–36	50*	No adjustment	360
1936–37	Nil	30	410
1937–38	30	12	420
1938–39	Nil	—	380

Irish Free State Income.—Although Cases IV and V, dealt with above, cover Foreign income belonging to a person resident in this country, the basis of assessment in the case of Irish Free State income accruing to such a person is :—

(1) Irish Free State Securities, Stocks, Shares, or Rents—the actual income of the year of assessment, whether remitted to this country or not.

(2) Land, Houses, or other property owned and occupied by

* Although no income arose during the year, the assessment is made on the usual preceding year basis, since the source of the income was in the taxpayer's possession during the year of assessment (*Sec.* 22, *F.A.*, 1926).

him in the Irish Free State—an amount equal to the current year's assessment in the Irish Free State (on the net annual value under Irish Free State, Schedule A).

(3) Land occupied by him in the Irish Free State (except Lands occupied as nurseries or gardens for the sale of produce)—an amount equal to the assessable value of the lands as ascertained for the purpose of Irish Free State, Schedule B.

(4) In respect of other income arising in the Irish Free State —the computation is made on the same basis as if the income had arisen in this country. For instance, business profits, salaries, directors' fees, and bank interest will be assessed (except in the opening and closing years) on the basis of the preceeding year Subject to :—

(*a*) the deduction of any annual interest, annuity or other annual payment payable out of the income to a person *not* resident in G.B. & N.I.

(*b*) the same allowances, deductions and reliefs as if the income had arisen in G.B. & N.I.

NOTE.—The Irish Free State based its taxation laws on our Income Tax Act, 1918, and the provisions of its Finance Acts since 1922–23 have followed very closely those of G.B. & N.I., with a few important differences.

Double Taxation Relief.—The British Government and the Government of the Irish Free State (I.F.S.) have agreed to the following reliefs for 1926–27 onwards :—

1. If a person is resident in G.B. & N.I. and *not* resident in the I.F.S., the I.F.S. authorities will exempt him from I.F.S. tax on income arising in the I.F.S.

2. If a person is resident in the I.F.S. and *not* resident in G.B. & N.I., the British Government will exempt him from British tax on that part of his income arising in G.B. & N.I.

NOTE.—For these purposes a Company, whether incorporated by or under the laws of G.B. & N.I., or of the I.F.S., or otherwise, is to be deemed resident in that country only in which its business is managed and controlled.

3. A person resident in both countries will be taxed in both countries, but will obtain relief in both countries on the doubly-taxed income. The relief given in each country is at half the lower of the person's two appropriate rates, the British or the Irish. The appropriate rate in each case is found by dividing the tax payable (before the deduction of Life Assurance allowance) by the *total* income from all sources, adding the sur-tax rate (found by dividing the sur-tax payable by the total income).

PARTNERSHIPS.

Although a partnership is not a legal entity, a separate return of all untaxed income of a partnership is required to be made by the precedent acting partner, and the tax is collected from the firm in the

firm name, without specifying the individual partners' shares of such tax payable. If any of the partners are entitled to any personal allowances, these will be given effect to in the firm's assessment, if such individual partner makes a separate return showing his total income and claiming the allowances.

The firm's return must show :—

(1) Details of untaxed income of the firm liable for assessment.

(2) Details of income of the firm already taxed.

(3) Details of annual charges such as loan or mortgage interest, ground rents, etc., payable by the firm.

(4) Names and addresses of the partners and a statement showing how the partnership income is divided between the partners.

The division of the partnership profits should normally be made as follows:—

(1) From the profits of the Trade, Profession, etc., returned for assessment under Schedule D (less the amount of Wear and Tear allowance, if any) deduct the amount by which the annual charges exceed the total of the other income of the firm (taxed or untaxed).

(2) Divide the balance according to the terms of the partnership agreement as in force for the year of assessment.

(3) If the annual charges are less than the other income of the firm, the excess should be divided as in (2).

(4) If there are annual charges, but no income other than business profits, the annual charges are deducted from the firm's assessment before division, and tax on such annual charges at the full standard rate is collected from the firm in addition to the total of the individual partners' tax.

Illustration (11).—A and B are in partnership, sharing profits in the ratio of 3 : 2. The adjusted profit for the year to March 31, 1938, was £1,000 and the Wear and Tear allowance for 1938–39 was agreed at £20.

The partners agreed that salaries for the year to March 31, 1939, should be A, £500 ; B, £300, and interest on capitals (A, £1,500; B, £900) should be at 5 % per annum.

The firm owned the business premises (leasehold) assessed at £220 gross, subject to a ground rent of £20 per annum and mortgage interest £50.

Name.	Address.	Division of Profit.		Basis of Distribution of Balance.	Amount of Partners' Share of Balance.	Amount of Partners' Share of other Income of Firm.
		Salary.	Interest on Capital.			
		£	£		£	£
A	—	500	75	3/5	36	66
B	—	300	45	2/5	24	44
		£800	£120	—	£60	£110

The following are the details for the 1938-39 Schedule D return :—

Untaxed Income : Partnership Profits			£1,000
Less Wear and Tear			20
			£980
Taxed Income : Schedule A assessment (net) ..		£180	
Annual Charges : Ground Rent	£20		
Mortgage Interest	50		
		70	
			£110

NOTE.—A would enter on his personal return £611 as his share of the untaxed profits, and B, £369. These amounts, together with the shares of the taxed income, £66 and £44 as shown above, constitute each partner's income from the business, and are the figures to be taken into account in determining allowances, as well as each partner's liability (if any) for sur-tax.

Personal Allowances.—Certain allowances of tax from the total tax, which would otherwise be payable, are given to individuals (not to companies or corporations) which reduce the effective rate of tax suffered, and may, in some cases, give total exemption. In order to obtain these allowances, the taxpayer must make a return of his total income from all sources, taxed and untaxed, and definitely claim each allowance. These reliefs can only be given from the net tax payable after deducting from the total liability the tax on any annual charges for which the taxpayer is accountable.

A married man must include his wife's income with his own, the wife being entitled to no allowances, unless she claims "separate assessment" (*see* below).

Earned Income Allowance.—(1) A deduction of tax at the standard rate on £300, or on one-fifth of the net earned income, whichever is the less.

(2) A similar allowance in respect of his whole income, whether earned or unearned, may be claimed where either the taxpayer, or, in the case of a married man, his wife living with him, was on April 6th, at the commencement of the year of assessment, 65 years of age, or more, and the total income does not exceed £500.

Marginal Relief.—Where the total income exceeds £500, the tax payable on the total income will be reduced where necessary, so as not to exceed a sum equal to the total of (i) the amount of tax which would have been payable if the total income had been just £500, and (ii) one-half of the amount by which the total income exceeds £500 (*see Illustration* 15 (*b*), p. 870).

Personal Allowances.—(3) A personal allowance may be claimed of tax at the standard rate on £100, or, in the case of a married man whose wife is living with him, on £180.*

* The allowance on £180 extends also to the case of a married man who proves that his wife, although not living with him, is wholly maintained by him, and that he is not entitled, in computing his income for the purposes of Income Tax, to make any deduction in respect of the sums paid by him for the maintenance of his wife.

Where the total income includes any earned income of the wife, an additional allowance may be claimed of tax at the standard rate on four-fifths of the amount of such earned income (subject to a maximum additional allowance of tax at the standard rate on £45).

Exemption.—(3*a*) Since 1935–36 total exemption is granted *in every case* where the income does not exceed £125 in all, and where the income is less than £140 the tax payable is not to exceed one-fifth of the amount by which the income exceeds £125. It will be seen that this special exempting provision is only of benefit to unmarried persons, and in cases where the income, or the greater part of it, is unearned. In all other cases the ordinary personal and earned income allowances (see above) would by themselves serve to procure exemption (*see Illustrations* (17) and (17*a*), p. 871).

(4) A deduction of tax at the standard rate on £50 may be claimed by (*a*) a widower who has a female relative of his or of his deceased wife resident with him for the purpose of having the charge and care of any child or adopted child of his in respect of whom the deduction for children is given, or in the capacity of a housekeeper, or (*b*) a widow who has a female relative of hers or of her deceased husband resident with her for the same purpose.*

If the widower or widow proves that he or she has no such female relative who is able or willing to take such charge or act in such capacity, the same deduction may be claimed in respect of some other female person employed for the purpose.

(5) A deduction of tax at the standard rate on £50 may be claimed by an unmarried person who has living with him, and maintains at his own expense, either his mother (being a widow or living apart from her husband), or some other female relative, for the purpose of having the charge and care of any brother or sister of his in respect of whom the deduction for children or adopted children is given.† (A female taxpayer may claim in respect of either her mother or a female relative in the circumstances set out.)

(6) A deduction of tax at the standard rate on £60 may be claimed in respect of any child, stepchild or adopted child* living at any time within the year of assessment, who was either under the age of 16 years at the commencement of the year of assessment, or who, if over that age, was receiving full-time instruction at any university, college, school, or other educational establishment. (" Adopted child " means, for this purpose, a child of whom the individual has the custody and whom he or she maintains.)

* The deductions in respect of a female relative referred to in (4) and (5), and in respect of an adopted child referred to in (6), are conditional upon proof being given that no other individual is entitled to any deduction for Income Tax in respect of such female relative or adopted child, or, if any other individual is so entitled, that such individual has relinquished his or her claim to the deduction. If several persons contribute, each may claim a proportionate allowance.

As from 1938–39 this allowance extends to a child undergoing whole time training as an apprentice for any trade, profession or vocation, provided that (*a*) the period of such training is not less than two years, and (*b*) the remuneration of the "child" (if any), exclusive of any returns of premium, does not exceed £13 per annum.

No deduction can, however, be allowed in respect of any child or adopted child who is entitled in his or her own right to an income which, after excluding any income from a scholarship, bursary, or other similar educational endowment, exceeds £50 a year.

(7) *Dependent Relative.*—An allowance of tax at the standard rate on £25 may be claimed in respect of any person whom the individual maintains at his own expense, and who is (i) a relative of his, or of his wife, and incapacitated by old age or infirmity from maintaining himself or herself, or (ii) his or his wife's widowed mother, whether incapacitated or not, or (iii) his daughter who is resident with him and upon whose services he is compelled to depend by reason of old age or infirmity. (A female taxpayer may claim in respect of (i) a relative of hers or of her husband, or (ii) her or her husband's widowed mother, or (iii) her daughter, in the circumstances set out.)

No deduction can, however, be allowed under (i) or (ii) if the income of the dependent relative exceeds £50 a year.

Where two or more persons jointly maintain a dependent relative as above, the deduction is to be apportioned between them in proportion to the amount or value of their respective contributions.

(8) *Reduced Rate Relief.*—In order to give further relief to small incomes, a portion of the taxable income, up to a stated limit, bears tax at a reduced rate. The particulars of this relief, which has been altered several times in recent years, are as follows:—

1931–32 to 1934–35	Up to first £175 of taxable income taxed at half standard rate.
1935–36 to 1937–38	Up to £135 taxed at one-third of the standard rate.
1938–39	Up to £135 taxed at 1s. 8d. (Compared with standard rate 5s. 6d.)

(9) *Rates of Tax Chargeable.*—The standard rates of income tax has been as follows:—

1931–32, 1932–33, 1933–34	5s. in the £
1934–35 and 1935–36	4s. 6d. in the £
1936–37	4s. 9d. in the £
1937–38	5s. 0d. in the £
1938–39	5s. 6d. in the £

Sur-tax.—For 1928–29, and for 1929–30 and onwards, the following respective rates were levied in excess of the standard

rate, in respect of the excess over £2,000 of the total income, less charges, of an individual:—

			1928–29		1929–30 to 1937–38	
			s.	d.	s.	d.
On every £ of the first	£500	of the excess	0	9	1	0
,, ,, next	500	,,	1	0	1	3
,, ,, ,,	1,000	,,	1	6	2	0
,, ,, ,,	1,000	,,	2	3	3	0
,, ,, ,,	1,000	,,	3	0	3	6
,, ,, ,,	2,000	,,	3	6	4	0
,, ,, ,,	2,000	,,	4	0	5	0
,, ,, ,,	5,000	,,	4	6	5	6
,, ,, ,,	5,000	,,	5	0	6	0
,, ,, ,,	10,000	,,	5	6	6	6
,, ,, ,,	20,000	,,	6	0	7	0
,, ,, remainder		,,	6	0	7	6

In addition, for the years 1930–31 and onwards an additional amount of tax is payable equal to 10 per cent. of the tax as calculated from the above table (*Finance* (No. 2) *Act*, 1931).

(10) An allowance of tax (but not sur-tax) may be claimed in respect of premiums paid for Life Assurance, or for contracts for Deferred Annuities. The allowance is authorised in respect of (*a*) premiums (whether annual or not) paid by the claimant on his own life or that of his wife, (*b*) premiums (whether annual or not) paid by the claimant's wife out of her separate income on her own life or on that of her husband, and (*c*) any sum which the claimant, under any Act of Parliament or under the conditions of his employment, is liable to pay, or to have deducted from his salary, to secure a deferred annuity to his widow or provision for his children after his death.

The allowance due will be calculated at the following rates:—

(i) Where the policy was effected *after* June 22, 1916: At half the standard rate in the £ in all cases, but see (*c*) below.

(ii) Where the policy was effected *on or before* June 22, 1916: (*a*) at half the standard rate in the £ if the total income does not exceed £1,000; (*b*) at three-fourths of the standard rate in the £ if the total income exceeds £1,000 but does not exceed £2,000;* (*c*) at the full standard rate in the £ if the total income exceeds £2,000.

The allowance is subject to the following limitations:—

(*a*) The total amount on which the allowance is calculated is not to exceed one-sixth of the claimant's total income from all sources for the year of claim.

(*b*) In the case of any policy securing a capital sum on death (whether in conjunction with any other benefit or not) the amount on which the allowance is calculated is

* Marginal relief is granted when the total income is slightly less than £1,000 or £2,000, as the case may be. For method of working see illustration on p. 870.

not to exceed 7 per cent. of that capital sum, exclusive of any additional benefit by way of bonus or otherwise.

(*c*) In the case of policies or contracts which do not secure a capital sum on death, the total amount on which the allowance is calculated is not to exceed £100, and the policies must have been taken out not later than June 22, 1916. In the case of such policies or contracts effected after that date, no allowance is to be made, except where they have been effected in connection with certain superannuation or pension schemes.

(*d*) In the case of a deferred assurance made after June 22, 1916, no allowance is to be made in respect of premiums payable during the period of deferment, except where the assurance was effected in connection with certain superannuation or pension schemes.

(*e*) For 1935–36 and onwards, where the claimant's *taxable* income does not exceed £135 the relief in respect of any premiums is to be at a rate not exceeding one-third* of the standard rate. If the claimant's taxable income exceeds £135, but the amount of the premiums is greater than the excess of the income over £135, the rate of allowance on the difference is restricted to one-third.*

The first time a claim under this provision is made, or when a new policy is taken out, the Inspector will usually require production of the premium receipt or the new policy. In view of this, some assurance companies when issuing a new policy now supply with it a certificate, setting out the material particulars which will be accepted by the Inspector.

Persons Resident Abroad.—The reliefs referred to above are not granted to an individual who is not resident in G.B. & N.I., unless he or she satisfies the Commissioners of Inland Revenue that he or she (i) is a British Subject; or (ii) is or has been employed in the service of the Crown; or (iii) is employed in the service of any missionary society or of any native State under the protection of His Majesty; or (iv) is resident in the Isle of Man or the Channel Islands; or (v) has previously resided within G.B. & N.I. and is resident abroad for the sake of his or her health, or the health of a member of his or her family, resident with him or her, or (vi) is a widow whose late husband was in the service of the Crown.

The allowance due to Non-Residents in such cases is restricted to the fraction of the total relief due if the person had been resident in this country, equal to the fraction of his total income which arises in this country.

Earned Income is defined by *Section* 14 *of the Income Tax Act*, 1918, and includes:—

* Or for 1938–39 1s. 8d. in the £.

(*a*) Remuneration from any office or employment, pensions (including Civil List Pensions), superannuation or other allowance, deferred pay or compensation for loss of office given in respect of the past services of an individual or of the husband or parent of the individual.

(*b*) Income from property forming part of the emoluments of office of an individual.

(*c*) Income charged under Schedule B or Schedule D or the rules applicable to Schedule D and immediately derived by the individual from the carrying on or exercise by him of his trade, profession, or vocation, either as an individual or in the case of a partnership, as a partner personally acting therein.

General Illustration of Reliefs and Allowances (12):—

Bunthorne, resident in England, has the following income taxable in 1938–39: Business Profits (as agreed), £160; Wear and Tear allowance, £40. War Loan interest (untaxed), £105. Property: Net Schedule A assessments, £200; Ground Rents payable, £20; Mortgage Interest payable, £70. Directors' Fees, £280; Wife's Directors' Fees, £60. Wife's Dividends, £110 (all taxed at source). He has three children, one born on April 5, 1939, one aged eight, and one aged twenty-two at Oxford (his income, excluding a scholarship worth £70 per annum, amounts to £45). Bunthorne maintains his wife's widowed mother (whose income is £45 per annum). He pays life assurance premiums as follows:—

	Capital Sum.	Premium.
On his own life, taken out June 20, 1915 ..	£500	£15
On his wife's life, taken out June 20, 1915 ..	500	17
On his child's life, taken out June 20, 1915 ..	150	2
His wife pays:—		
On her own life, taken out July 1926	£1,000	£80
On her husband's life, taken out July 1926 ..	1,000	100
On her mother's life, taken out July 1926 ..	200	20

			£
Husband's Income:—			
Schedule D, Case I, £160, *less* Wear and Tear, £40			120
Schedule D, Case III			105
Schedule A		£200	
Less Annual Charges, Ground Rent	£20		
Mortgage Interest	70		
		90	
			110
Schedule E			280
Wife's Income:—			
Schedule E			60
Taxed Dividends			110
Statutory Total Income			£785
Less Allowances:—			
Earned Income $\frac{1}{5}$th of (120 + 280 + 60)		£92	
Personal		180	
Additional personal		45	
Children (£60 each)		180	
Dependent Relative (widowed mother)		25	
			522
Taxable Income			£263

	£	s.	d.
Tax payable on £135 @ 1s. 8d.	11	5	0
,, ,, ,, 128 @ 5s. 6d.	35	4	0
£263	£46	9	0

Less Life Assurance Allowance:—

Premium £15, allowable ..	£15	
17, allowable ..	17	
2, allowable ..	—	
80, allowable ..	70	(restricted to 7% of sum assured)
100, allowable ..	70	
20, allowable ..	—	
	£172	

Restricted to ⅙th of Total Income *i.e.* to £131

Allowance: £128 at 2s. 9d.	£17	12	0			
£3 at 1s. 8d.		5	0			
				17	17	0
Tax actually borne by Bunthorne				28	12	0
Add Tax on Annual Charges, £90 at 5s. 6d.				24	15	0
Total Tax payable by Bunthorne				£53	7	0
By deduction at source						
Dividends £110 at 5s. 6d.	£30	5	0			
By Assessment	23	2	0			
	£53	7	0			

ILLUSTRATION (13):—

RELIEF TO NON-RESIDENTS.

G. Dickson, a British subject resident in France, is married and has one child under sixteen. His income for 1938–39 is £210, made up of £150 from property in France and £60 from property in England (from which British tax has been deducted by the tenants).

The appropriate allowances are:—

Personal Allowance	£180	
Child Allowance	60	
		£240

and as these allowances exceed the total income, repayment is made of all the British tax suffered, i.e. £60 @ 5s. 6d. = £16 10s. 0d.

ILLUSTRATION (14):—

RELIEF TO NON-RESIDENTS.

C. Testout, a British subject resident in Borneo, has the following income for 1938–39:—

Foreign and Non-Liable Income:—

Salary	£600	
Dividends from Foreign Companies	10	
4% Funding Loan*	6	
		£616

* Interest or dividends on certain British Government Securities, if the beneficial owner is not ordinarily resident in G.B. & N.I., are exempt from British Tax. The securities in question include: 3½% War Loan, and 4% Funding Loan.

Liable Income:—

N.A.V. of Property in G.B. & N.I.	£53	
Dividends from British Companies	250	
Bank Deposit Interest	5	
		308
		£924

Testout is married, has no children, but supports his widowed mother, who lives with him.

If the whole income were liable to, and had borne, British tax at the full Standard Rate, repayment due would be:—

			£	s.	d.
Personal Allowance	£180 @ 5s. 6d.	=	49	10	0
Earned Income Allowance	120 @ 5s. 6d.	=	33	0	0
Dependent Relative	25 @ 5s. 6d.	=	6	17	6
Reduced Rate Relief	135 @ 3s. 10d.	=	25	17	6
			£115	5	0

As, however, £308 only is liable, the repayment due is restricted to:—

	£	s.	d.	£	s.	d.
$\frac{308}{924}$ = ⅓rd of £115 5 0 .. .. =				38	8	4
Add Tax on Funding Loan, taxed at source, but exempt in his hands £6 @ 5s. 6d. ..	1	13	0			
Less Tax due on untaxed Bank Interest, £5 @ 5s. 6d.	1	7	6			
				0	5	6
Repayment				£38	13	10

Alternatively, the repayment may be calculated as follows:—

Total Statutory Income		£924
Less: Earned Income Allowance	£120	
Personal Allowance	180	
Dependent Relative Allowance	25	
		325
Taxable Income		£599

	£	s.	d.
Tax payable—			
£135 @ 1s. 8d.	11	5	0
£464 @ 5s. 6d.	127	12	0
£599	£138	17	0

	£	s.	d.	£	s.	d.
⅓ thereof				46	5	8
Less: Tax deducted at source on:—						
Funding Loan .. £6 @ 5s. 6d.	1	13	0			
Rents of Property £53 @ 5s. 6d.	14	11	6			
Dividends £250 @ 5s. 6d.	68	15	0			
				84	19	6
Repayment				£38	13	10

ILLUSTRATION (15):—

"OLD AGE" RELIEF.

(*a*) A married man, resident in G.B. & N.I., has an earned income of £300. His wife, aged sixty-six, has income from property (Net Annual Value), £45.

Total Income ..		£345
Less Allowances:		
Old Age, $\frac{1}{5}$th of £345	£69	
Personal	180	
		249
Taxable Income		£96
Tax payable thereon @ 1s. 8d.		£8 0 0

(*b*) A bachelor, aged seventy, has an income consisting of dividends from British Companies producing £510 per annum (gross amount).

But for marginal relief he would pay on	£510
Less Personal Allowance	100
	£410

		£	s.	d.
Tax payable £135 @ 1s. 8d.	=	11	5	0
£275 @ 5s. 6d.	=	75	12	6
£410		£86	17	6

His liability is, however, restricted to tax on £500, plus half of the excess of his income over £500, as follows:—

			£	s.	d.
		£500			
Less one-fifth	100				
Personal Allowance	100				
		200			
		£300			
£135 @ 1s. 8d.		=	11	5	0
£165 @ 5s. 6d.		=	45	7	6
			56	12	6
Add half excess of income over £500		=	5	0	0
			£61	12	6

Since he has suffered tax by deduction on £510 @ 5s. 6d. = £140 5s. 0d., he is entitled to repayment of £78 12s. 6d.

ILLUSTRATION (16):—

LIFE ASSURANCE—MARGINAL RELIEF.

Hugh Dickson, with an income of £980, pays £160 on a life policy on his own life for £3,000, taken out in January 1916.

Since his income does not exceed £1,000, he is entitled to relief on:—

£160 @ 2s. 9d. only = £22

Marginal relief increases this allowance to:—

Tax on £160 @ 4s. 1½d. .. .. =	£33 0 0
Less Tax @ 5s. 6d. on amount by which total income falls short of £1,000, i.e. £20 @ 5s. 6d.	5 10 0
Life Assurance Relief due	£27 10 0

ILLUSTRATION (17):—

EXEMPTION OF INCOME UP TO £125

Muriel Johnson, spinster, aged 25, has an income of £120 derived from an annuity from her deceased father's estate. She is exempt from tax, and if tax has been deducted at the source (as it would have been) she may recover the whole amount, viz. £120 @ 5s. 6d. = £33. But for this special exemption she would have been liable as follows: Total Income £120, *less* Personal Allowance = £20 Taxable Income. The Tax @ 1s. 8d. = £1 13s. 4d. The repayment would therefore have been for £31 6s. 8d. only. On the other hand, had her age been 65 the operation of "old age" relief would have sufficed in any case to procure her exemption.

ILLUSTRATION (17*a*):—

Suppose Muriel Johnson's annuity in the above case amounted to £135. Her liability calculated in the ordinary way would be as follows: Total Income £135, *less* Personal Allowance £100 = £35 Taxable Income. The Tax @ 1s. 8d. = £2 18s. 4d. The "marginal relief" provision, however (*see* p. 863) reduces this to one-fifth of £10, this being the excess of the income over £125, and the liability is therefore £2. As tax will have been suffered by deduction to the extent of 5s. 6d. on £135, viz. £37 2s. 6d., the repayment will amount to £35 2s. 6d.

MARRIED WOMEN.

The income of a married woman living with her husband or wholly maintained by him is deemed to be part of the husband's income. It must be included in his return and taxed in his name.

If, however, application is made in the prescribed form by either the husband or the wife, within six months before July 6th in the year of claim (or in the case of persons marrying during the course of the year of assessment, before July 6th in the following year), the total tax payable will be divided between the husband and the wife, and separately assessed on them; the total relief so given is not to exceed the relief which would have been granted if no application had been made.

The allowances are apportioned as follows:—

Earned Income Allowance—in the ratio of their respective *earned* incomes.

Old Age Relief—in ratio of their respective *total* incomes.

Personal Allowance (including additional allowance of four-fifths of wife's earned income), Children Allowance, and reduced rate relief on £135—in ratio of their respective incomes after deduct-

ing amounts on which tax has been allowed for Earned Income Relief.

Dependent Relative or adopted child allowance—to party maintaining relative or child.

Life Assurance relief—to party by whom the payment is made.

ILLUSTRATION (18):—

Mr. A. has the following income assessable 1938-39: Business Profits, £250, less Wear and Tear, £5; Directors' Fees, £50; Taxed Dividends (gross amount), £100.

His wife has income from property Net Annual Value, £110, her salary as a teacher is £160, and she supports her widowed mother.

The husband pays £10 on a Policy for £100 on his wife's life, taken out in 1923, and the wife pays £30 on a Policy for £1,000 on her husband's life, taken out in 1919.

The first column shows the total tax collected from the husband if no application is made for separate assessment; columns 2 and 3 show the tax collected from the husband and wife separately if application is made before July 6, 1938.

It should be noted that the husband has already borne tax by deduction amounting to £100 @ 5s. 6d. = £27 10s. 0d., and the wife £110 @ 5s. 6d. = £30 5s. 0d. The husband will therefore have to pay £12 1s. 8d. by direct assessment while the wife will receive a repayment of £12 2s. 2d.

	1 Total.		2 Husband.		3 Wife.	
Earned Income:—		£		£		£
Directors' Fees and Salary ..		210		50		160
Business Profits (*less* W. & T.) ..		245		245		—
Taxed Income (Unearned)		210		100		110
Total Income		665		395		270
Less E. I. Relief (1/5th)		91		59		32
		574		336		238
Less Personal Allowance £180 Additional Allowance 45	£ 225		£ 132		£ 93	
Divisible 336 : 238						
Dependent Relative ..	25	250		132	25	118
Taxable Income		324		204		120
Taxable at 1s. 8d. (ratio 336 : 238)		135		79		56
Balance @ 5s. 6d.		£189		£125		£64
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Tax payable @ 1s. 8d.	11 5 0		6 11 8		4 13 4	
Tax payable @ 5s. 6d.	51 19 6		34 7 6		17 12 0	
		63 4 6		40 19 2		22 5 4
Less Life Assurance Allowances:						
Husband, £10 @ 2s. 9d. ..	1 7 6			1 7 6		
Wife, £30 @ 2s. 9d. ..	4 2 6					4 2 6
		5 10 0				
		£57 14 6		£39 11 8		£18 2 10

Dominion Income Tax Relief.—Income from the Irish Free State has already been dealt with.

Income from a Dominion (any British Possession, or any territory under the protection of His Majesty, or under British or Dominion Mandate) is taxed on the net amount plus an addition for the tax charged in the Dominion. Where, however, the Dominion does not grant reciprocal relief in respect of the payment of British tax, the addition is restricted to the amount of relief allowed in this country.

If any person (this term includes companies and non-residents) proves that he has paid both British tax and Dominion tax for the same year on the same source of income, he is entitled to relief from British tax on such doubly taxed income at the lower of the following rates:—

(*a*) The Dominion rate of tax.

This is found by dividing the Dominion tax paid for the year of claim (the Dominion year ending within the British fiscal year is taken) by the Dominion income; or

(*b*) One-half of the appropriate rate of British tax—found by adding

(i) The income tax rate for the year of claim (not the Standard Rate, but the rate arrived at by dividing the tax payable on the taxable income, i.e. ignoring Life Assurance allowance or Dominion Tax relief, by the taxable income); and

(ii) The Sur-tax rate—Sur-tax payable for the preceding year divided by total income for the preceding year.

Due Date for Payment of Tax.—Income tax due on an assessment is payable in one sum on the 1st January during the year of assessment *except* in the case of tax due from individuals and partnerships under:—

Schedule B in respect of lands occupied for the purpose of husbandry, only;

Schedule D or the rules thereof—in respect of the profits or gains of any trade, profession, or vocation;

and tax due from individuals under:—

Schedule E in respect of any office or employment;

In these cases the tax is payable in two equal instalments, the first on 1st January in the year of assessment, and the second on 1st July.

Super-Tax and Sur-Tax.

Sur-tax, as already explained on p. 865, is an additional tax levied on all *individuals* having incomes in excess of £2,000. This tax supersedes and replaces super-tax, which was last charged in 1928-29 and was calculated in a similar way. Sur-tax is payable in one sum as a deferred instalment of income tax on January 1st *following* the year of assessment and the rates are set out in the Finance Act for the year following the year of assessment. Sur-tax for 1928–29 (the

first year of this tax) was therefore payable on 1st January, 1930, and sur-tax for 1937–38 is regulated by the Finance Act 1938 and payable on 1st January, 1939.

When an individual dies within the year of assessment the amount of sur-tax payable for that year is not to exceed the amount that would have been payable according to the rates applicable to the previous year (F.A. 1930, S. 26), e.g. suppose the taxpayer dies in November 1937. According to the rates of sur-tax for 1937–38, the estate will be liable to pay on the income received between 6th April, 1937, and the date of death at the rates determined by the Finance Act of 1937 as applicable for the purposes of sur-tax 1936–37. (It will, of course, also be liable for sur-tax 1936–37, which will probably not have been paid by the deceased, not being due till 1st January, 1938.)

ILLUSTRATION (19):—

Black has the following income for 1937–38:

Taxed by assessment:—

Case I, Schedule D, Business Profits, £2,000, less Wear and Tear, £55.
Case III, War Loan, £700 (afterwards reduced to £560).
Schedule A (net annual values), £350.

Taxed by deduction:—

Sundry Dividends, gross £420 (net £310).

Annual Charges:—

Ground Rents paid January and December 1937, £30.
Mortgage Interest on mortgage paid off 1st July, 1937, together with one year's interest amounting to £60.

His wife's income for 1937–38 was:—

Directors' Fees, Schedule E assessment, £75 (later reduced to actual, £55).
Interest on £5,000 3½ % War Loan (Bearer Bonds).
Bank Interest paid during the year ended 31st March, 1938, £15.

SUR-TAX, 1937–38.

Husband's Income:—		
Schedule D, Case I	£1,945	
Schedule D, Case III	560	
Schedule A	350	
Dividends	420	
		£3,275
Wife's Income:—		
Directors' Fees	£55	
3½ % War Loan	175	
		230
		£3,505

Less Charges:—			
Husband: Ground Rent	£30		
Interest	60		
	90		
Wife: Bank Interest	15		
		105	
		£3,400	

	£	s.	d.
Sur-tax payable:—			
on £2,000, nil			
on 500 @ 1s. 0d.	25	0	0
on 500 @ 1s. 3d.	31	5	0
on 400 @ 2s. 0d.	40	0	0
£3,400	96	5	0
Add 10 %	9	12	6
Tax payable 1st January, 1939	£105	17	6

If either the husband or wife makes application for that purpose, not later than 6th July, 1938, separate assessments will be raised, as follows:—

Husband: Income	£3,275	
Less Charges	90	
		£3,185
Wife: Income	£230	
Less Charges	15	
		215
		£3,400

Tax payable by husband:—			
$\frac{3,185}{3,400}$ of £105 17s. 6d.	£99	3	7
by wife:—			
$\frac{215}{3,400}$ of £105 17s. 6d.	6	13	11
	£105	17	6

It should be particularly noticed that no allowances or reliefs may be deducted in calculating sur-tax, in particular (a rather common source of misconception) the earned income allowance does not apply. Only " annual charges " are allowed, and bank interest, but this last will only be admitted if a certificate is procured from the bank on the official form.

Annual charges for this purpose include annual payments made in accordance with an agreement under seal (irrevocable by the taxpayer) covering a period of not less than seven years; but if the recipient of the payment is a child of the taxpayer the period of the agreement must be for the life of the taxpayer or until the child marries. (F.A. 1922, S. 19). So long as the child is a minor the charge will only

be allowed if the agreement was made before 22nd April, 1936, and is "irrevocable." F.A. 1936, S. 21.)

Advantage of this fact is sometimes taken by taxpayers who wish to make regular subscriptions to charitable institutions. Instead of making the usual voluntary payment a seven-year agreement under seal is entered into. The taxpayer deducts income tax when making the payments (thereby saving himself income tax) and the payment is also treated as a charge for the purpose of sur-tax. The charity, being exempt from tax, reclaims the tax deducted and has the advantage of being assured of a regular income.

Interest on money borrowed in order to pay the premiums on life assurance policies is allowed as a charge subject to certain restrictions (F.A. 1930, S. 13). The restriction is mainly directed to "single-premium" policies, which prior to 1930 were extensively resorted to as a means of avoiding tax.

In certain circumstances sur-tax may be charged on the undistributed income of private companies. As to this, see Finance Act 1922, S. 21, and Finance Act 1927, S. 31. Subject to this proviso sur-tax is a personal tax, assessed on individuals only.

Memorandum on the Liability of Non-Residents and Non-British Subjects.

Considerable confusion appears to exist in the minds of students and others on the question of the liability of non-residents, and non-British subjects, to tax in this country. The question bristles with difficulties, and each case must be considered on its merits; but the following outline should assist.

Income may be divided into two broad classes:—

1. Income Arising in this Country.—This is always liable to British tax; so that a non-resident, whether a British subject or not, will be liable to British tax on income from land or buildings in G.B. & N.I. owned by him, from land in G.B. & N.I. occupied by him, from any trade, profession or vocation carried on by him in G.B. & N.I., and from any other British securities or possessions. There are two exceptions:—

(*a*) Interest and dividends on certain British Government Securities are exempt from British tax if the beneficial owner is not *ordinarily resident* in this country (*see* footnote, p. 868).

(*b*) Persons resident in the I.F.S. and not resident in G.B. & N.I. are exempt from British tax under the double taxation agreement between this country and the I.F.S.

2. Income Arising Abroad.—This is exempt in the case of non-residents; but the title to be regarded as non-resident is lost for any fiscal year in which a person visits this country, unless he come here:—

(*a*) For some temporary purpose only, and

(*b*) Without any intention of establishing a residence, and

(*c*) The total period of his stay here in the year does not amount to six months (*Rule 2, Miscellaneous Rules, Schedule D, Income Tax Act*, 1918).

It has been held that a person may reside and have an ordinary residence in more than one country in the same year, and many cases have been decided in the Courts as to whether, in various circumstances, a particular person is resident or not.

The income from Foreign and Dominion securities, stocks, shares or rents is assessed under Cases IV and V in Schedule D on the full amount of the income arising in the preceding year, whether the income has been or will be received in G.B. & N.I. or not. But if a person satisfies the Commissioners of Inland Revenue that he is not *domiciled* in G.B. & N.I., or that, being a British subject, he is not *ordinarily resident* in G.B. & N.I., such income will be assessed on the basis of the amounts *remitted* to this country during the preceding year.

A person, whether a British subject or not, assessed to British tax as a "resident" is entitled to the personal allowances, but a non-resident assessed to tax is not entitled to these allowances unless he is a British subject, or comes within the other exceptions mentioned on p. 866.

National Defence Contribution.

National Defence Contribution (familiarly referred to as N.D.C.) is a new tax, levied by the Finance Act 1937, to last for a period of five years commencing on April 1st, 1937. It is assessed on the profits of all businesses (but excluding professions and "public utility" companies) carried on in the United Kingdom, whether these are in the form of limited companies, partnerships or sole traders.

Basis of Assessment.—The tax is levied at 5 per cent. on the assessable profits in the case of limited companies and 4 per cent. in other cases. With certain exceptions (stated below) the profits on which the tax is to be charged are calculated in the same way as for Income Tax Schedule D, but the "preceding year" basis as used for income tax purposes does not apply. Instead, the profits assessed are the actual profits of the "accounting period," i.e. in the ordinary way the year of account, whenever that may end, and an assessment is made as soon as practicable after the end of the period and the tax is payable one month after assessment. Assessments (including additional assessments) may be made at any time up to six years after the end of the accounting period in question.

A taxpayer who objects to an assessment has the right of appeal either to the general or special commissioners.

EXEMPTION AND ABATEMENT.—Profit less than £2,000 is exempt.

If the profit (for a whole year) is less than £12,000, the profits are reduced for the purpose of assessment by a sum equal to one-fifth of the amount by which the profit falls short of £12,000.

Example.—The adjusted profit of X Ltd. for the year to 30th June, 1938, is £9,000. The abatement is one-fifth of £3,000 = £600, and the tax for the year is 5 per cent. on £8,400 = £420.

APPORTIONMENT.—If the period of account is partly before and partly after 1st April, 1937, the first " accounting period " is that portion from 1st April to the end of the period. The profit is (normally) apportioned on a time basis in months and fractions of months and the abatement is similarly apportioned.

Example.—The adjusted profit of P, a sole trader, for the year ended 31st December, 1937, was £10,000.

The abatement (on the basis of a full year) is one-fifth of £2,000 = £400, and the chargeable profit is therefore:—

3/4 of £9,600 = £7,200
Tax—4 per cent. on £7,200 = £288

COMPUTATION OF PROFITS.—With certain important exceptions the computation of profits is the same as for the purposes of Income Tax Schedule D, Case I. The intention is that it is the *trading* profit which is the subject of charge, and consequently interest and dividends received are excluded (in the case of a trading company) whether or not income tax on such interest, etc., may have been deducted at the source.

On the other hand, interest paid, whether or not under deduction of income tax, is generally an admissible charge. The non-allowance for income tax purposes of annual interest paid out of profits is bound up with the principle of deduction of tax at the source, but this principle has no application to N.D.C. which is not in any sense a " personal " tax as income tax is.

The remaining important variation in the computation, as compared with income tax practice, relates to the case where the business owns its own premises: for N.D.C. purposes the annual value of such premises is *not* allowed as a deduction.

Wear and Tear is allowed as a deduction as for income tax, including the additional allowance.

Income Tax and N.D.C. are not allowable expenses in computing profits for N.D.C. purposes, but N.D.C. charged in respect of any period of account is an allowable expense in computing the profits of that period for income tax purposes.

Example.—The following is a summary of the Profit and Loss Account of M Ltd., a public company, for the year to 30th June, 1938:—

Gross Profit		£28,600
Dividends and Interest		3,200
		31,800
Less Directors' Fees	£2,000	
Sundry Expenses allowable for Income Tax	5,100	
Depreciation	1,300	
Sundry Expenses treated as Capital for tax purposes	800	
Income Tax	1,200	
Reserve for N.D.C.	950	11,350
		20,450
Less Debenture Interest	2,000	
Dividends paid	15,000	17,000
		£3,450

The adjusted profit will be found as follows:—

Net Profit for the year	£20,450
Less Dividends, etc., received	3,200
	17,250
Add Depreciation	1,300
Expenses as for Income Tax	800
Income Tax	1,200
N.D.C.	950
	21,500
Less Debenture Interest	2,000
	19,500
Less Wear and Tear (say)	1,100
Profit chargeable at 5 per cent.	£18,400

Note particularly that though the Dividends paid are not allowed as a deduction the Debenture Interest is.

LOSSES.—Where a loss is sustained during a "chargeable" accounting period, it may be carried forward, from year to year if necessary, and set off against the profit in the next available accounting period or periods. Losses sustained before the commencement of N.D.C. may be carried forward and set off against profits in the N.D.C. period subject to a time limit of six years, as for income tax purposes.

COMPANIES WHOSE DIRECTORS HAVE A CONTROLLING INTEREST.—Where the directors have a "controlling interest," the total deduction to be allowed in respect of the "remuneration" of directors other than "whole time service directors" is limited. The limit applies to all such directors together (not each of them) and is either £1,500

or 15 per cent. of the adjusted profit after disallowing all such remuneration, whichever is the greater, subject to a limit of £15,000 in any case.

A "whole time service director" is defined as a director who devotes substantially his whole time to the business and is not the *beneficial* owner of more than 5 per cent. of the ordinary share capital.

The "remuneration" means remuneration of any sort and in addition to fees may include, for instance, commission, interest or rents.

Example.—A, B and C own the whole of the ordinary capital of P Ltd., A holding 60 per cent. of the ordinary shares, B 38 per cent., and C 2 per cent.

C is then a "whole time service director" within the meaning of the Act but A and B are not.

Suppose the adjusted profit in a chargeable accounting period, before making any disallowance in respect of A and B's remuneration, is £14,500, and that the "remuneration" is as follows:—

A—fees £750, commission £340, total £1,090.
B—fees £750, debenture interest £1,200, total £1,950.

The profit will be adjusted as follows:—

Profit as stated		£14,500
Add remuneration to A	£1,090	
remuneration to B	1,950	3,040
		17,540
Less allowed, 15 per cent. of £17,540, being more than £1,500		2,631
		£14,909

PARTNERSHIPS.—An individual or partnership can, of course, not claim any deduction for interest, salary, etc., paid to himself or any partner. As against this, there is the advantage of paying the tax at 4 per cent. only instead of 5 per cent.

There is, however, a concession whereby, on notice of a claim to that effect being given within one month of the end of the chargeable accounting period, such a business may elect to be treated as though it were a company controlled by the partners, the partners not being "whole time service directors." This concession is useful when the profits are not too large as it permits deduction of not less than £1,500 for the remuneration of the partners. As against this, the rate of tax is increased from 4 per cent. to 5 per cent.

Example.—D and E are partners in D & Co., sharing profits in the proportion of 3 to 2. For the year to 30th June, 1938, D received interest on capital £120 and E £100, and E received salary £300. The adjusted profit (after adding back both interest and salary) was £4,600.

Assuming the option not to be exercised, the abatement will be £1,480, leaving taxable profit £3,120.

Tax at 4 per cent. = £124 16s. 0d.

It will, however, be an advantage to exercise the option, as follows:—

Adjusted profit as above	£4,600
Less allowed for remuneration	1,500
	3,100
Less abatement: one-fifth of £8,900	1,780
	£1,320

Tax thereon at 5 per cent - £66.
This would be divided between the partners as follows:-

	Total	D	E
	£	£	£
Interest	220	120	100
Salary	300	—	300
Balance (3 : 2)	4,080	2,448	1,632
	4,600	2,568	2,032
Less Remuneration £1,500 and Abatement £1,780, total £3,280, split in the proportion 2,568 to 2,032	3,280	1,831	1,449
	£1,320	£737	£583
Tax at 5 per cent.	£66 0 0	£36 17 0	£29 3 0

There are special provisions affecting banks and investment companies, holding and subsidiary companies, and building societies, which space does not allow to be set out here.

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